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"TURNAROUND STRATEGIES FOR SEVERE CRISES. SURVIVING A BANKRUPTCY PROCEDURE"

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A mi padre y mi hermana,
a los familiares, amigos y colegas que me han acompañado en la investigación,
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"Success is how high you bounce when you hit the bottom"

George S. Patton

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Introduction

Business turnaround (BT) has been a matter of interest for strategy scholars during decades. A renewed interest on BT has aroused (Mann and Byun, 2017; Schweizer and Nienhaus, 2017), given the high number of firms which have suffered operational or financial struggles during the Great Recession. This research focuses on declining firms that suffer the most severe financial distress, bankruptcy, and also have the willing to survive and restore their performance. Consequently, firms with limited life expectations, which decided to wind their assets up or were taken over were discarded.

How firms face organizational decline and recover their prior performance is the focus of BT (Hofer, 1980), a question that must be answered in the context of business strategy. In fact, "the reason why firms succeed or fail is perhaps the central question in strategy" (Porter 1991: 95). However, as Trahms et al. (2013: 1278) stated: "the concerns and challenges managers face when executing an organizational turnaround are unique and distinct from those of improving performance in a non-decline situation". Therefore, BT remains substantially different from other strategic areas, given the particularities of a declining situation.

When facing a viability-threatening decline, firms must react in order to reverse it (Weitzel and Jonsson, 1989) through the implementation of turnaround strategies. A complete BT embraces the diagnosis of the turnaround *situation*, the implementation of adequate turnaround *responses*, which result in the turnaround *outcome*. However, BT has been often confused with other organizational-change actions which have more limited scope and do not have the aim to take the firm out of a survival-threatening situation (Pandit, 2000). This poses relevant difficulties in the study of turnarounds and its correct understanding. To set a clear pace for this research's theoretical framework a review of the relevant literature of organizational decline and turnaround was carried out. Drawing on such literature, several questions were asked: Is the turnaround framework suitable for bankrupt firms? Are turnaround strategies effective in providing survival and recover performance of the bankrupt firms? Does the intensity of the response impact the turnaround outcome? Does the competitive environment moderate the adoption of turnaround strategies?

This research has a marked proactive nature: firms must react to decline if they want to survive and restore their performance. Doing nothing or even acting late has detrimental far-reaching consequences derived from the dynamic nature of organizational decline (Tangpong et al., 2015). Also, these actions are conditioned by the contextual factors and causes of decline, so a tailor-made design should be implemented for a successful turnaround to be achieved. Besides, the actions that must be taken are to impact the whole firm's structure, and the subsequent organizational changes will affect both strategical and operational spheres of the firm. The complete turnaround process, if implemented properly, produces a significant transformation in both firm's structure and behavior and, as a result, in its performance (McKiernan, 2003).

Therefore, despite recent efforts directed by policymakers to encourage firm creation and entrepreneurship, this research's position is that the rotation of the number of firms should be reduced by allowing the existing ones to survive. This does not mean that survival should be achieved at any cost. As the literature proposes, non-viable firms must cease their operations, and their resources must be reallocated in profitable projects (Altman and Hotchkiss, 2006; Cook et al., 2011). At the same time, viable firms experiencing distress must be saved and turned around, in order to preserve employment, the value of assets and their know-how (Gilson, 2010).

An additional motivation of this thesis comes from the acquisition of a relatively deep knowledge of bankruptcy in Spain derived from the professional activity of the researcher. In all developed countries bankruptcy regimes deal with corporate insolvency, this is, the firm's inability to pay back debts (López-Gutiérrez et al., 2012). As it occurred in comparable countries, an important number of Spanish firms attempted turnaround from a position of bankruptcy, since the legal procedure provides interesting tools and mechanisms to stabilize decline, reorganize debts and restore performance (Fernández, 2004). However, the efficacy of the Spanish bankruptcy procedure is extremely low given that few firms survive at the end of it, in contrast to what happens in comparable environments (García-Posada and Mora-Sanguinetti, 2012). Thus, the Spanish

bankruptcy context deserved a specific investigation given that the effectiveness of turnaround strategies has proved extremely poor in this context.

Which may be the origin of disparities in turnaround strategies' effectiveness? According to BT literature, the difference among successful and failing firms is explained by the strategies adopted to reverse decline and recover prior performance (Robbins and Pearce, 1992). These are mainly classified into two stages which also embrace its strategic content: retrenchment and recovery (Pearce and Robbins, 1993). Retrenchment strategies focus on the stabilisation of decline and correction of operational inefficiencies (Bibeault, 1982; Hambrick and Schecter, 1983; Hofer, 1980; Pearce and Robbins, 1993), while recovery strategies aim to reorientate the firm towards sustainable competitive advantage (Barker and Duhaime 1997). The effectiveness of turnaround strategies is contingent on the causes and severity of decline, while some other factors contribute to shape the turnaround outcome (slack resources, competitive environment, leadership, etc). This research's focus is put on the effectiveness of turnaround strategies in the highest severity crisis (bankruptcy) which, accordingly to the reviewed organizational context, are expected to impact firms' survival likelihood and subsequent performance.

However, though prior empirical findings found consistent results regarding the effectiveness of some of the recovery strategies, empirical results for retrenchment strategies have proved inconsistent and equivocal. While Robbins and Pearce (1992) strongly support the need to adopt retrenchment strategies regardless of the cause of decline, subsequent studies have found contradictory results. For instance, Lim et al. (2013: 42) state: "… retrenchment is one of the most widely used strategies; nevertheless, it is a poorly understood and understudied topic … Empirical research supporting the efficacy of the retrenchment strategies has been limited or equivocal; and little is known about when, how, and in what form retrenchment should be used." Similarly, Trahms et al. (2013: 1296) assert: "Overall, the past two decades have witnessed an increase in the research examining the effect of retrenchment and strategic actions on turnaround performance. While the findings show a more consistent

and positive effect of strategic actions, the effect of retrenchment actions is far from settled."

Two main reasons have been proposed to explain the contradictory results. In first place, samples have been overly heterogeneous. Particularly, sampled firms attempting turnaround have not begun at the same starting point. Solvent and insolvent firms have been mixed within broad definitions of decline that include profitable firms underperforming industry average and unprofitable firms in threat of liquidation (Pandit, 2000; Schweizer and Nienhaus, 2017). Similarly, broad definitions of what constitutes a turnaround have mixed firms that aim to survive with others aiming to achieve sustainable competitive advantage and so above industry average performance. Secondly, some relevant variables, such as the competitive environment, were conceptually considered in prior turnaround studies (Lim et al., 2013; Ndofor et al., 2013) but their effects on high severity situations were overlooked.

This thesis addresses these weaknesses. On one hand, it samples firms with similar starting points: all are insolvent and attempting turnaround within a legal bankruptcy process. The terms "insolvency" and "bankruptcy" are differentiated in this research. "Insolvency" refers to the inability to make debt repayments due to financial distress while "Bankruptcy" refers to a formal Court proceeding. These terms are often used as synonyms (Altman and Hotchkiss 2006). Nonetheless, in this research, an *insolvent* firm (unable to pay its debts) must subsequently file for *bankruptcy* (a formal procedure). Only one study examined the importance of turnaround for insolvent firms within bankruptcy (Collett et al., 2014) but it did not focus on the effectiveness of those turnaround strategies. This neglect is explained by Franks and Sussman (2005) who argue that legal bankruptcy regimes have been misunderstood as means for firm liquidation and so have been abandoned by turnaround scholars. On the other hand, this research considers the effectiveness of both retrenchment and recovery strategies within a homogeneous sample of firms suffering a severe decline and the moderating role of the competitive environment. An often ignored variable, the intensity of the response, was also studied, given the evidences of its relevance provided by prior scholars (Sudarsanam and Lai, 2001).

Consequently, this research's main hypotheses are that in a bankruptcy procedure the adoption of certain retrenchment and recovery strategies will impact the probability of successful turnarounds. This is unpacked by testing the link between turnaround success with cost and asset retrenchment and sales increase and investments as recovery strategies. Additionally, both bankruptcy and turnaround backgrounds were linked by overlapping the outcomes of the first (liquidation vs survival) with the outcomes of the second (success vs failure). As a result, three possible outcomes were designed to test the validity of findings: liquidation, marginal survival and successful survival. Also, the shaping role of the competitive environment was taken into consideration according to prior studies (Morrow et al., 2004; Ndofor et al., 2013).

Based on a sample of Spanish bankrupt firms as analytical setting, the vast majority of them being small and medium-size enterprises (SMEs), the findings suggest that cost retrenchment and sales increase are valid turnaround strategies to increase the likelihood of success within bankruptcy, regardless of the competitive environment. Conversely, asset retrenchment and acquisitions were not generally recommended to bankrupt firms and their effectiveness was moderated by the competitive environment. While munificent contexts provided opportunities for investment and penalized those firms which reduced assets, in stagnating and declining environments bankrupt firms were prescribed to retrench assets and undertaking no additional investments. Also, empirical evidences suggest that, on one hand, surviving a bankruptcy procedure relied strongly on structural factors such as size, slack or prior performance. However, on the other hand, the success (achieving both survival and performance improvement) of bankrupt firms during the procedure was underpinned on the firms' own actions and initiative rather than on external or prior conditions.

Therefore, the contributions and implications of this research are varied. Firstly, it extends the existing body of research in turnaround literature, by overcoming two common limitations, heterogenous samplings and the lack of interest in bankrupt firms. This helps to shed to light in the effectiveness of turnaround strategies, particularly on high severity decline situations, and adds supplementary nuances to the complex turnaround process. Particularly, the

findings showed that retrenchment and recovery are not panacea and its effects should be disaggregated. Whereas asset retrenchment conveys detrimental effects, specifically in munificent environments, cost retrenchment is positively associated with success in every context. Also, that investing during bankruptcy is not a general recommended recovery action, while increasing sales improves the probabilities to achieve successful turnarounds. Consequently, asset-related strategies should be carefully scrutinized during bankruptcy.

Secondly, the research contributes to provide legislators with an empirical validation of measures to achieve survival. Since the aim is to address the effectiveness of turnaround strategies adopted by bankrupt firms, the results contribute to explain the reasons why some firms survive successfully, and others do not. Therefore, a renewed framework is required to ease the adoption of the strategies which better help firm survival within bankruptcy. Also, to implement additional measures that motivate managers to undertake them in order to prevent, or at least, adequately face bankruptcy in the future.

Managerial practice is also enriched with the validation of those recipes that make bankrupt firms viable. Firms' managers need to choose the set of strategies that best fit with their environment and their resources and capabilities (Amit and Schoemaker, 1993; Barney, 1991; Barney et al., 2001; Penrose, 1959; Peteraf, 1993), so providing them with those that have proved successful will accelerate and ease the decision process. Additionally, given the central role that bankruptcy administrators play during the proceeding as supervisors and Court assistants, the study also contributes to their capacity of addressing the firms' situation and advising the managers with the actions that best preserve the principles of the proceeding.

Finally, it must be borne in mind that the rescue of firms is also a relevant socio-economic issue, since it allows for the employment conservation, prevents firms' decapitalization and helps to safeguarding of invaluable know-how and expertise which, on the contrary, will be dramatically damaged and the economy will be deprived of them. Nobody doubts that economically unviable firms should abandon the market and permit the reallocation of resources. Nevertheless, the lack of an efficient bankruptcy system results in lower levels

of potential recovery for the future (López-Gutiérrez et al., 2012), and financial resources are allocated from nonperforming assets to profitable ones in a costly and slowly manner, which has been nothing strange in the Spanish economy during the years of crisis. Additionally, if no second chance is given to entrepreneurs, the creation of new firms will be discouraged, and firm renewal will also suffer an unacceptable sinking.

1. Bankruptcy and turnaround during the Great Recession.

The Great Recession period affected firms from developed countries in similar ways: loss of economic confidence, restricted access to finance, sales decrease, leverage rising, job redundancies and business closing (Madrid-Guijarro et al., 2011). As the EC (2014) points out, an average of 200,000 firms went bankrupt each year in the EU during the Great Recession, resulting in job losses totaling 5.1 million over three years (2012-14). Also, a large proportion of SMEs were unable to pay back their short-term liabilities as they fall due (e.g. 24% in the UK in 2012). In summary, when contracting demand and reduced access to finance occur, the economic conditions for a firm and its employees, customers, banks, suppliers and shareholders become increasingly difficult and it is common that the firm's survival is put under threat.

Nonetheless, the economic crisis has also shown the existence of firms able to resist such a hostile environment, and they have exited the worst years of Gross Domestic Product (GDP) drop with renewed forces and an extraordinary resilience capacity. Such capacity has been gained through huge efforts by firm's managers, who have dealt with the relation of factors derived from the crisis. To that aim, turnaround strategies have proved key to successful survival during this critical period (Schoenberg et al., 2013).

Few available data explicitly capture the number and situation of firms attempting turnarounds. The reason for such lack of data may lay in the own nature of turnaround: firms suffering decline are not inclined to share their experiences except when the crisis situation has passed through and performance has been restored (Weitzel and Jonsson, 1989). Prior academic studies on turnaround situations have obtained their data from general firms' databases

filtering by selected criteria, such as a number of years of performance decline under some threshold. However, such criteria have resulted in heterogeneous samples and, consequently, in nonconclusive outcomes (Pandit, 2000).

Conversely, bankruptcy offers interesting opportunities in terms of homogeneous samples and relevant data. Bankruptcy occurs when the firm suffers a severe decline and, as a result, it cannot pay its debts on time and in the amounts arranged with its creditors (Gilson, 2010). This is nothing new in developed countries, where the evolution of bankruptcy frameworks has been directed by the deeper understanding of the phenomenon and its negative consequences on the socio-economic environment. As the IMF (2014) suggested, countries should set forth bankruptcy regimes which deal with two types of firms: viable or non-viable. Viable firms should be given the chance to reorganize, reduce their indebtedness, improve their operating conditions or, in the worst case, sold as going concerns. Conversely, non-viable firms should be rapidly liquidated at the lowest cost for stakeholders, while the recovered resources should be devoted to profitable projects. Therefore, the aim of a bankruptcy system should be to save economically viable firms while liquidating non-viable ones (Cook et al., 2011; Madrid-Guijarro, et al., 2011).

Bankruptcy also raises the dilemma of saving *firms* or saving *businesses* (Mokal, 2004). Businesses are productive units that are able to make products, create jobs or obtain revenues, while firms are the legal entities created for the purpose of carrying on a business. In a strict economic sense, a bankruptcy procedure should focus mainly in preserve businesses rather than firms. However, new regulations highlight the value of preserving firms as well, given that their formal and informal structures, culture and know-how will barely be preserved in case that the business is sold separately (Garrido, 2012).

1.1. Bankruptcies in Europe and the US.

Developed countries saw a dramatic increase in the number of firm bankruptcies during the Great Recession, as depicted in Table 0.1. (Creditreform, 2017). The majority of them suffered a peak of firm bankruptcies during the first recessionary wave (2008-10) that relaxed until the second

contraction period (2012-13). Since then, a general downward trend is shown by bankruptcies figures, which however rarely recover the pre-crisis numbers.

Despite the existence of a common evolution of bankruptcies' figures, several differences among countries deserve to be highlighted. Firstly, France is the country with the highest number of firm bankruptcies (around 55,000 per year), although it has a smaller firm population than USA (around 44,000 per year) or Germany (around 28,000 per year). Secondly, Spain is the fifth economy in Western Europe, with a similar firm population and GDP to Italy. However, bankruptcy figures in Spain (around 5,000 per year) can be matched with those of much smaller countries, such as Denmark (around 4,900 per year), Austria (around 6,000 per year) or Portugal (around 5,800 per year). This signals to a wide variety of efficiency degrees in dealing with bankruptcy among developed countries, related to bankruptcy culture, entrepreneurship rates or judicial efficiency (Bollet et al., 2015).

Table 0.1. Firm bankruptcies in Western Europe and USA (2007-2016).

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Austria	6.362	6.500	7.076	6.657	6.194	6.266	5.626	5.600	5.422	5.534
Belgium	7.678	8.476	9.382	9.570	10.182	10.587	11.739	10.736	9.762	9.170
Denmark	2.401	3.709	5.710	6.461	5.447	5.456	4.993	4.049	4.029	6.674
Finland	2.254	2.612	3.275	2.864	3.005	2.956	3.131	2.954	2.574	2.408
France	42.532	49.723	53.547	51.060	49.506	59.556	60.980	60.853	61.429	56.288
Germany	29.510	29.580	32.930	32.060	30.200	28.720	26.120	24.030	23.180	21.560
Greece	524	359	355	355	452	415	392	330	189	108
Ireland	363	773	1.406	1.525	1.631	1.684	1.365	1.164	1.049	1.032
Italy	5.518	6.498	8.354	10.089	11.792	12.311	14.272	16.101	16.015	15.057
Luxembourg	680	590	698	918	961	1.033	1.016	845	873	983
Netherlands	4.602	4.635	8.040	7.211	7.000	7.373	8.375	6.645	5.271	4.399
Norway	2.845	3.637	5.013	4.435	4.361	3.814	4.564	4.803	4.462	4.544
Portugal	2.123	3.267	4.450	5.144	6.025	7.763	8.131	6.773	7.288	7.168
Spain	1.033	2.894	5.175	4.990	5.910	7.799	9.143	6.392	4.916	4.080
Sweden	5.791	6.298	7.892	7.546	7.177	7.737	7.701	7.158	6.433	6.019
Switzerland	4.314	4.222	5.215	6.255	6.661	6.841	6.495	5.867	6.098	6.504
UK	12.893	16.268	19.908	17.468	18.571	21.252	18.935	17.660	15.983	17.927
USA	28.322	43.546	60.837	56.282	48.500	57.768	44.122	34.588	29.897	37.997

Source: Creditreform (2017).

Regarding survival rates, according to McCormack et al. (2016) the disparity of firms saved in bankruptcy proceedings in Europe is huge. For

instance, while Finland provides survival rates near to 50% of bankrupt firms, in Germany survival reduces to 25% of bankrupt firms, while Spain shows one of the lowest survival rates, with only 7% of firms entering the procedure. Extant literature points to several causes of this low efficiency related to three types of efficiency (López-Gutiérrez et al., 2012). On one hand, the *ex ante* efficiency intends to prevent debtors from making decision against the creditor's interests. Accordingly, a regime focused in *ex ante* efficiency can be discouraging for firms, and as a result firms arrive to bankruptcy when is too late, so their financial and economic situation is severely deteriorated, thus little can be done for them. On the other hand, the *interim efficiency* is oriented to maximize the value of firms before bankruptcy. This could lead firms to make sub-optimal decisions, such as underinvestment or overinvestment (López-Gutiérrez, 2015). Finally, *ex post* efficiency relates to the maximization of the bankrupt firm's value as a result of the proceeding. Traditionally, bankruptcy regimes with the highest survival rates are *ex post* efficiency-focused (Claessens and Klapper, 2005).

Given its far-reaching effects, the issue of bankruptcy and turnaround is integrated in the political agenda since the very beginning of the EC (2000) and, in the light of the Great Recession, a new legal framework has been encouraged from European authorities. Recent Regulations (EC, 2015) and Proposal for Directive (EC, 2016) promote firm restructuring and survival, given the socio-economic benefits that a saved firm provides to an economy. At the same time, this new regulatory trend advocates for liquidating and dissolving non-viable firms which, on the current framework, are probably able to delay bankruptcy declaration and further deteriorate their financial condition and their assets' value. In summary, an efficient bankruptcy regime must provide survival chances to viable but distressed firms, and a rapid solution for non-viable ones.

1.2. Bankruptcies in Spain.

Spain has not been an exception in this context. The Spanish bankruptcy law (*Ley Concursal*) was enacted in 2004, one of the years with higher GDP growth in the modern years. Consequently, the law did not respond to the need to articulate an efficient bankruptcy regime (for bankruptcies figures were little more than anecdotical), but to try to modernize a former one which came from

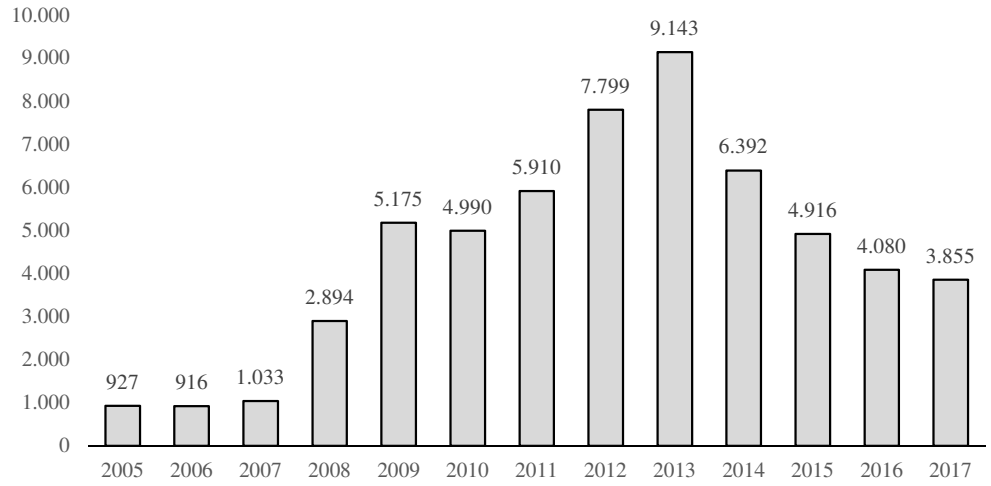
the beginning of the 20th century. However, since the enactment of the law (September 2004), a total of 59,136 firms (INE, 2017) have been declared bankrupt, amounting an estimated 65 billion euros in assets and liabilities and affecting 50,000 employees each year (Van Hemmen, 2016). Bankrupt firms' assets also represent one-third of the Non-Preforming Loans (NPLs) in the Spanish banking system (BdE, 2016). Therefore, the problem of bankruptcy has become a significant one and broadly affects the economic as well as the financial system.

Interest on bankruptcy has also increased due to the cases of Martinsa-Fadesa, S.A.[1], Blanco[2], Reyal-Urbis[3] or Pescanova[4], which have been notable examples of publicly traded firms which fell into bankruptcy, and either recovered, were liquidated or merely survived without significant improvements in their performance. Yet such high-profile bankruptcies are just the tip of the iceberg, since most of Spanish bankrupt firms are SMEs (Van Hemmen, 2016).

From barely 1,000 bankruptcies in Spain during 2007, they increased to more than 9,000 in 2013 as a result of the economic crisis, as shown in Figure 0.1. Since that year, bankruptcies have remarkably declined to below 4,000 cases in 2017. Nonetheless, this downward trend has stopped, pointing to a stabilization of the number of cases. In the close future it is expected that bankruptcies still add up to these significant figures and represent a persistent issue in the Spanish economy, as it is for the rest of developed countries (García-Posada and Mora-Sanguinetti, 2012). However, a wider experience and empirical knowledge will assist new bankrupt firms, given the significant advances produced, not only at regulative, but also at managerial level.

[1] http://elpais.com/diario/2008/07/28/economia/1217196001_850215.html.
[2] http://www.laopinioncoruna.es/economia/2013/06/19/juez-declara-concurso-acreedores-blanco/734182.html.
[3] http://www.elconfidencial.com/economia/2013-02-19/reyal-urbis-solicita-concurso-de-acreedores-con-una-deuda-de-unos-3-600-millones_289399/.
[4] http://economia.elpais.com/economia/2013/04/04/actualidad/1365104319_025768.html.

Figure 0.1. Firm bankruptcies in Spain (2005-2016).



Source: Instituto Nacional de Estadística (INE, 2017).

It must be highlighted though, that the effectiveness of the Spanish bankruptcy procedure is extremely low, because of two main problems. On one hand, the Spanish bankruptcy procedure has a very low usage, since only 14 in 10,000 firms enter the procedure. This is the lowest rate except for Greece (3 in 10,000 firms). On the other hand, the Spanish bankruptcy procedure provides a very low survival rate for bankrupt firms, given that only a 7% of the firms seeking protection under this regime achieve survival (Van Hemmen, 2016), well below of the EU or USA standards (Creditreform, 2017; Davydenko and Franks, 2008). This raises a question: What distinguishes those firms emerging from bankruptcy as a going concern and successfully run their business from those that fail? To answer that question, it is necessary to analyze the actions taken for those firms during the bankruptcy proceeding. In that purpose, the BT framework becomes extremely useful.

1.3. Linking bankruptcy and turnaround.

Despite the amplitude and current validity of the seminal turnaround literature (Bibeault, 1982; Hofer, 1980; Pearce and Robbins, 1993; Robbins and Pearce, 1992; Schendel and Patton, 1976; Schendel et al., 1976), bankrupt firms have been excluded from those studies, except for one paper (Collett et al., 2014). Franks and Sussman (2005) suggest that the lack of interest is explained because, mainly in the 80s and 90s, the bankruptcy regimes were mainly

designed to liquidate the firms' assets, and insolvency was considered as the death of the organization, as firstly proposed by Sheppard (1994). Therefore, the legal bankruptcy framework did not provide any interesting results for turnaround scholars.

Nevertheless, building on the "second chance" principle, recent regulatory trends have set up debtor-friendly frameworks based on the USA's Chapter 11, the one which claims to result in higher surviving firms' rate (Mokal, 2004). Madrid-Guijarro et al. (2011) showed that governments in many countries attempted to aid distressed firms by reforming their bankruptcy regimes so that they tackle decline in early stages. Additionally, the European Commission Proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvent and discharge procedures (EC, 2016), aim to establish pre-insolvency procedures, more agile and cheaper than the current ones, so as to improve firm survival rates and anticipate the adoption of actions to mitigate and reduce financial and economic distress. Spain has not remained unaware of these regulatory developments and, starting in 2011, has deeply reformed the bankruptcy law to adapt their principles to those of the EU. Some examples on the adoption of this new pre-insolvency regime (also called *preconcurso* or *acuerdo de refinanciación*) are Codere[5], Abengoa[6], Isolux[7][8] and, more recently, Grupo Prisa[9].

In this new context, it is worth to study how bankrupt firms achieve survival after going through a "purgatory" (bankruptcy procedure), under which expiate their sins and sanitize themselves, given the more adequate legal, social and economic framework recently enacted, thus covering a research gap that has been ignored before (Pandit, 2000; Trahms et al., 2013).

[5] http://www.eleconomista.es/empresas-finanzas/noticias/6096954/09/14/Rumores-de-acuerdo-Codere-podria-haber-cerrado-la-refinanciacion-de-su-deuda-.html
[6] http://www.europapress.es/economia/noticia-juez-homologa-acuerdo-refinanciacion-abengoa-evita-asi-concurso-20161108143256.html
[7] https://economia.elpais.com/economia/2016/07/14/actualidad/1468487164_488128.html
[8] Despite its restructuring plan, Isolux was not able to fulfill it and it has filed for bankruptcy on July 4, 2017. Currently, the firm is being liquidated. https://economia.elpais.com/economia/2017/07/04/actualidad/1499167935_183058.html
[9] https://cincodias.elpais.com/cincodias/2018/01/16/companias/1516137266_198290.html

2. Business turnaround literature and key research issues.

The BT conceptual framework is particularly useful in characterizing and determining the main antecedents, actions and results in the context of this research. A turnaround process reveals three related phases: the turnaround *situation*, the turnaround *response* and the turnaround *outcome* (Lohrke et al., 2004). When the viability of a firm is under threat, it is acknowledged to be in a *turnaround situation*, due to external or internal failures, or a combination of both (Pearce and Robbins, 1993). The measures adopted by firms whose survival is put in doubt, and which may permit allow their continuity, are called *turnaround responses* or *turnaround strategies* (Trahms et al., 2013). Finally, the result of the actions carried out is called the *turnaround outcome*, which can range from a real improvement in performance to a total failure (Lohrke et al., 2004). A complete business turnaround embraces the diagnosis, the actions and the final result of the turnaround situation (Slatter and Lovett, 1999).

In the context of this research, it is assumed that bankrupt firms are in a turnaround situation, since their survival is undoubtedly under risk. Additionally, they suffer the most extreme severity of decline, bankruptcy (Robbins and Pearce, 1992). Thus, taking that premise into consideration, the focus is put on both strategies/responses and outcomes of their particular turnaround processes. Additionally, the role of the competitive environment was accounted for, given its relevance according to prior literature.

Turnaround strategies are adopted to overcome a critical situation, and, as a result, the firm achieves survival and recovers the level of performance it had prior to a severe decline (Barker and Duhaime, 1997). Traditionally, it has been considered that turnaround strategies involve, in first place, the stabilization of the performance decline through cost-cutting and/or asset's reduction measures – retrenchment – (Robbins and Pearce, 1992) which provide the base for a future growth – recovery (Barker and Mone, 1994). Prior studies concluded that the success of turnaround measures is conditioned to the causes and severity of decline (Hofer, 1980).

Nonetheless, the effectiveness of turnaround strategies has proved unequal in empirical studies. While entrepreneurial initiatives (recovery measures) have shown homogeneous positive impacts in prior turnaround studies, research on retrenchment actions has resulted equivocal. One of the key assertions in business turnaround is that retrenchment is *necessary* regardless the cause of turnaround or severity of decline (Robbins and Pearce, 1992). However, subsequent research has shown a variety of results depending on environmental conditions (Morrow et al., 2004), the role of the rent creation mechanism (Lim et al., 2013) or proper timing of implementation (Tangpong et al., 2015).

The main research topics on BT are shown in Table 0.2. As it can be observed, scholars have paid attention both to process (organizational decline, timing) and content (retrenchment, recovery) aspects. Besides, they have focused on issues at a more micro level, dealing with both organizations and individuals (e.g. stakeholders, corporate governance, top management team, ownership, etc.).

Table 0.2. Business turnaround main research topics

Research topic	Description
Organizational decline	The process followed by a firm that suffers from performance decline due to internal or external factors
Turnaround process	The process followed by a firm when it suffers a decline, implements responses accordingly and reaches an outcome as a result of the turnaround
Turnaround content	The set of strategies implemented by firms attempting turnaround as a response to decline and subsequent recovery
Timing of actions	Sequence and rapidness of the turnaround responses to a declining performance.
Retrenchment	Actions and stage pursuing a reduction of costs or assets in order to increase efficiency of operations and raise quick cash for immediate survival
Stakeholders	Relationship, roles and influence in the turnaround process
Recovery	Actions and stage of the turnaround process pursuing the complete restoration of prior performance through repositioning or focusing strategies

Corporate governance	The set of principles and agents that play a relevant role in the firm's turnaround governance
Top management team	Characteristics and composition of both incumbent or entering top management teams from firms attempting turnarounds
Industry specificities	Idiosyncratic specificities of industries and their influence when attempting turnarounds
Family firms	Particularities of family-owned firms that attempt turnarounds, specifically those related to ownership, professional directors and resilience
Public firms	Performance indicators of decline, budget disposals, measurement of turnaround in public organizations

Source: Own elaboration.

In some cases, if decline is so severe that the firm cannot control it and even losses its stakeholders' support, the firm may become bankrupt (D'Aveni, 1989a), this means, that it is not able to pay its debts in the amounts agreed and in a timely manner. To deal with such situations, developed countries enacted bankruptcy proceedings (Altman and Hotchkiss, 2006; Claessens and Klapper, 2005). Normally, bankruptcy proceedings provide two types of solutions, survival through an agreement with creditors, or liquidation through assets selling. In the Spanish context, the bankruptcy proceeding is known as *Ley 22/2003, de 9 de julio, Concursal*, and these two alternative solutions are also regulated (Fernández, 2004). The survival alternative is called *convenio*, and the liquidation one is known as *liquidación*.

Arogyaswamy et al. (1995) suggested that declining firms should address three main aspects before attempting a complete turnaround: stakeholders' support withdrawal, loss of efficiency and deterioration of internal climate. The way to reverse them is through the adoption of turnaround strategies. Regarding the restricting possibilities allowed by bankruptcy regimes, the bankruptcy framework could be used to gain some valuable time that can be useful to implement value-preserving and value-increasing restructuring actions, given that creditors do not decide instantly whether they want the firm liquidated or surviving (Kahl, 2002). During the bankruptcy proceeding, normally managers or the bankruptcy administrator (*administrador concursal*) use the "automatic

stay" period (Claessens and Klapper, 2005) to convince creditors that the value of the firm is higher as a going concern than in liquidation. Thus, the rationale of this research is that the best way to contribute that impression is by adopting turnaround strategies that reverse the performance decline and make possible a profitable survival in the interest of all stakeholders.

In the extensive review addressed by Trahms et al. (2013), the authors suggest extending the scope of the turnaround literature by including more types of results, and not only the dualism successful/non-successful that traditionally have appeared in turnaround studies. Thus, an assortment of results is proposed, ranging from failure (assimilated to Chapter 7 bankruptcy or liquidation), through reorganization, discounted merger or acquisition, limping along, and recovery to premium merger or acquisition and sharp-bend recovery. The two first results (liquidation and reorganization) are the ones in which this research is focused given that they are restricted to the bankruptcy context.

Additionally, in Spain there has not been an extensive study on the survival actions undertook by bankrupt firms. In the beginning of the new legal framework, Fernández (2004) studied the effectiveness of the proceeding as a mean to select viable or non-viable firms, concluding that the Spanish proceeding promoted the *ex-post* efficiency, with a preference to liquidate viable firms in the benefit of creditors, despite the value destruction that this alternative may cause. After some years of the Law enactment and at the start of the economic crisis, Van Hemmen (2009) evaluated how the slowness of the proceeding led to significant value destruction by delaying the survival/liquidation decision, even in those cases in which liquidation was the clearest option. Finally, Aguiar-Díaz and Ruiz-Mallorquí (2013) studied how the financial configuration of the firm contributed to survival likelihood, concluding that a capital structure concentrated among banks provided higher survival rates than those cases in which there was a concentration in commercial creditors or there was not a clear predominance of none of those types of liabilities.

Consequently, given that the managerial strategies in this context have been unexplored, this research aims to contribute to the extant turnaround literature by incorporating both Spanish and bankrupt firms to the prior studies.

Bankruptcy in Spain has been restricted to the Law and Finance literature (Fernández, 2004; Pozuelo et al., 2013), and turnaround has been barely considered but in few previous studies (Nueno, 1992; Ruiz-Navarro, 1998; Toral-Pla, 2010; Zúñiga-Vicente and Vicente-Lorente, 2006), thus the Spanish context is also a relatively unmapped one, offering a potential for new findings in this field.

3. Research aim and structure.

This research's objective is to shed light on the effectiveness of turnaround strategies in bankrupt firms as well as studying the intensity of response and the moderating role of the competitive environment. The focus was put on the adoption of turnaround strategies in the belief that their implementation will have positive effects for bankrupt firms and will subsequently increase their probability to overcome the procedure as well as improve their profitability. A relevant lesson should be extracted: a declining firm must act to change its fate when becoming bankrupt. During decline, problems can arise among employees that fear for their jobs, creditors that harbour doubts of debt recovery, and buyers and suppliers concerned about future business with the firm. Difficulties and handicaps can multiply, making it difficult to recover from bankruptcy (Pajunen 2006). However, if turnaround is achieved and a viable firm is saved, the socioeconomic effects can be positive and significant (Tangpong et al., 2015).

Additional motivations of this research are the following. In first place, despite the number of bankruptcy cases has receded during the last four years, the figure will not fall into the numbers showed prior to the economic crisis, so further research is needed in the business failure context to contribute turnaround strategies. Secondly, the Spanish bankruptcy framework has been deeply reformed in recent years with the goal to provide higher survival rates (García-Posada and Vegas, 2016). Thirdly, the majority of studies in failure are focused on large bankruptcy cases, although the challenges that Spanish firms – mainly SMEs – confront might be significantly different. By analyzing the effectiveness of strategies that make possible the survival of Spanish bankrupt firms this study

reveals relevant implications for scholars, legislators and firms' managers, as well as for the socio-economic context.

This research is divided in five chapters. In Chapter 1, a review on the theoretical framework was carried out. The main literature bodies addressed are those related with BT, financial distress and corporate bankruptcy, from which the research hypotheses are extracted. The study of the turnaround strategies' effectiveness will take as a starting point the conceptual framework of Robbins and Pearce (1992) and Arogyaswamy et al. (1995). However, the studied strategies are extracted from the most recent turnaround literature, which has explored the dynamics of the variables involved in the research (Boyne and Meier, 2009; Filatotchev and Toms, 2006; Lim et al., 2013; Ndofor et al., 2013; Tangpong et al., 2015).

In Chapter 2 prior literature findings are bridged and the hypotheses construction is exposed. Chapter 3 deals with the research methodology. Similarly to prior authors (Bruton et al., 2003; Schmitt and Raisch, 2013; Tangpong et al., 2015), the suggested models examine the explanatory power of turnaround strategies in addressing the efficacy of providing successful outcomes. As a result, a quantitative research was designed, and the multinomial logistic regression was chosen as the model for empirical validation.

To analyze the impact of turnaround strategies, the changes in financial structure of the firm between the moment of become bankrupt and the date of achieving an outcome were studied. A sample of 599 Spanish bankrupt firms from SABI database was used to validate the hypotheses. In Chapter 4 the empirical results are presented, and the main findings and implications to this research and the existing turnaround literature are discussed. Finally, in Chapter 5 conclusions are set forth, along with a summary of the study's contributions and limitations and areas of potential future research.

Chapter 1. Business turnaround situation, process, response and outcome

Introduction.

BT has attracted substantial academic attention in the last 40 years. Several economic crises took place since the 1970s decade, and subsequent organizational troubles arose in firms worldwide, from which prior turnaround authors found interesting commonalities (Hofer, 1980; Pearce and Robbins, 1992; Schweizer and Nienhaus, 2017). Since that period, the turnaround literature has been widely expanded both theoretically and empirically, despite the lack of an integrative view of all its aspects, particularly those related with the scope and content of turnaround strategies (Trahms et al., 2013). The initial purpose of this research thus, is to understand and extend the existing knowledge on the BT process and its content (turnaround strategies), by carrying a review on the most relevant and influential contributions in the fields of BT. The areas of bankruptcy and financial distress are also involved, since several of its principles are directly and indirectly applicable. This research, thus, integrates the three mentioned areas, focusing on the strategic management of bankrupt firms, while other related fields such as financial economics and the legal perspective of bankruptcy have also been taken into consideration.

Some authors from the most recent literature in BT (Lim et al., 2013; Tangpong et al., 2015; Trahms et al., 2013) have called for an extensive evaluation of what is really known regarding organizational decline and recovery. The number of declining and bankrupt firms has dramatically increased during the Great Recession and, as it happened in prior crises, a greater number failed rather than recovered (Balgobin and Pandit, 2001). Despite its long history and importance, the findings in this field have been inconclusive or misleading. As Pandit (2000) suggests, the cause of this slow progress can be due to problems with research design and the lack of a solid theoretical guidance. Consequently, a thorough literature review is needed in order to redraw the extant knowledge and have a complete understanding of the phenomena. This also helps to figure out the incomplete or unraveled issues from prior studies where efforts are still required in this research field.

Spain is also a rather unexplored field in the matter of BT and bankruptcy. Only three studies have been found regarding the issue for Spanish firms (Ruiz-

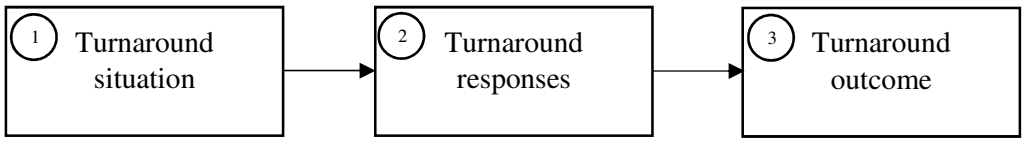
Navarro, 1998; Toral-Pla, 2010; Zúñiga-Vicente and Vicente-Lorente, 2006). However, they neither address the problem from the turnaround strategies perspective, nor employ bankrupt firms in their studies. Bankruptcy in Spain has been a field restricted to Law or Finance literature (Fernández, 2004; Pozuelo et al., 2013), thus offers great possibilities for turnaround literature to expand its theoretical framework on the area.

Therefore, the literature review aims to contribute the described gaps and try to discover the incomplete topics in the research field. The blocks for the description of the main research idea are built in the subsequent chapters. The main contributions to the extant literature are the following. In first place, the linkage of the turnaround literature and bankruptcy, an abandoned matter by turnaround scholars, is proposed. Given the recent enactment of debtor-friendly regimes, the lack of interest in bankruptcy could have come to an end, and thus the BT framework is positioned as one that may contribute decisively to bankrupt firm survival and recovery, a matter with significant socio-economic interest. In the following sections, these general assertions are discussed on the grounds of recent research. Additionally, a characterization of the bankruptcy context for turnaround strategies is proposed, from which relevant implications for legislators, scholars and practitioners are derived.

1.1. Business turnaround research and literature background.

BT literature has focused on how firms develop, react and succeed or fail in their attempts to reverse significant performance declines that put them in threat of disappearance (Pearce and Robbins, 1993). Consequently, prior scholars have distinguished among (1) the turnaround *situation*, (2) the turnaround *responses* and (3) the turnaround *outcome* (Lohrke et al., 2004), as depicted in Figure 1.1. The field's origins may be placed in the seminal studies of Argenti (1976), Schendel and Patton (1976), Schendel et al. (1976), Hofer (1980), Harrigan (1980), Bibeault (1982), Hambrick and Schecter (1983) and O'Neill (1986a) which established the grounds for later studies on the characterization of a turnaround situation and the proposed strategies that contribute to overcome decline. Those grounds resulted in the two-stage model by Robbins and Pearce (1992).

Figure 1.1. Overview of a business turnaround.



Source: Own elaboration.

BT research remains of high relevance for several reasons. In first place, turnaround strategies are adopted in a substantially different context than in non-declining firms, and so are concerns and challenges that managers face during a turnaround (Trahms et al., 2013). Second, BT has far-reaching consequences for the firm. In a first stage, the firm suffers the consequences of decline (Weitzel and Jonson, 1989). In a second stage, the firm reacts to decline, by adopting drastic actions that often reduce the firm's strategic scope abandoning those business areas that are unprofitable. Therefore, such measures will yield undertaking strong divestitures, cost-cutting measures or lay-offs (Tangpong et al., 2015). In the final stage, the firm must implement strategic reorientation towards profitable market niches (Barker and Duhaime, 1997). However, the turnaround outcome is not guaranteed, but instead could range from liquidation to sharp performance growth (Robbins and Pearce, 1992).

In summary, the idea of *turnaround* unveils a complete organizational change necessary to restore a desirable performance position. During a turnaround, problems normally arise among employees that fear for their jobs, creditors that harbour doubts of debt recovery, and buyers and suppliers concerned about future business with the firm (O'Neill, 1986b; Schoenberg et al., 2013). Difficulties and handicaps can multiply, making it difficult to recover from decline (Pajunen 2006). However, if turnaround is achieved, and a viable firm is saved, the socio-economic effects can be positive and significant. Consequently, governments around the world have considerable interest in facilitating firms' recovery by articulating adequate legal frameworks, despite the many drawbacks that it implies, particularly to creditors.

Since the 1990s crisis, several advances have been made in the turnaround research. Currently, the main paradigm on the business turnaround literature is the two-stage model of Robbins and Pearce (1992), which proposed the retrenchment-recovery process. Subsequent empirical and theoretical studies have taken that conceptual framework as a starting point to study the content of turnaround strategies. Barker and Mone (1994) challenged some of the paradigm grounds and built their propositions on the belief that only strategic actions (reorientation) provided a complete turnaround. This idea was reinforced by Barker and Duhaime (1997). However, as pointed out by Boyne and Meier (2009) the theoretical framework put forward by Robbins and Pearce (1992) is extremely useful to develop a complete BT perspective.

Later on, Chowdhury (2002) opened the research discussion by introducing a stage-perspective. The author focused on the different phases that a declining firm passed through until a turnaround was reached. Morrow et al. (2004) found that retrenchment strategies had unequal effectiveness depending on the firm's context. Pajunen (2006) and Filatotchev and Toms (2006) increased the traditional conceptual context towards the consideration of stakeholders, building on D'Aveni (1989a). In parallel, several studies have contributed to the management and TMT perceptions and reactions to decline and turnaround (Barker and Barr, 2002; Barker and Mone, 1998; Chen, 2015; D'Aveni, 1989b; Hambrick and D'Aveni, 1992). Finally, the Great Recession

has renewed the interest on the issue. This period has witnessed substantial extension of retrenchment understanding (Boyne and Meier, 2009; Lim et al., 2013; Santana et al., 2017; Schmitt and Raisch, 2013; Tangpong et al., 2015). Additionally, three comprehensive reviews have been recently published (Schoenberg et al., 2013; Schweizer and Nienhaus, 2017; Trahms et al., 2013), in which the most relevant conceptions have been gathered and potential future research streams have been proposed.

1.1.1. Main concepts in business turnaround.

The most frequent terms in BT studies are organizational decline, turnaround strategies, downward spiral, retrenchment, recovery, repositioning, downsizing, failure, bankruptcy, insolvency, distress, restructuring, and strategic change. These terms help to define the turnaround *process*. Such process has been divided in three stages which unfold once the firm starts to decline, establishes and implements a response and either recovers or fails. *Organizational decline* is part of what has been called the "dynamics of organization" or "organizational life-cycle" (Weitzel and Jonsson, 1989; Whetten, 1987). While firm growth has been widely studied, and authors even have considered it a "normal" status for the firm (Cameron et al., 1987a), organizational decline has been paid less attention until recent years. *Decline* normally reveals a downward spiral which, if not stabilized and reversed, will probably lead the firm in a sequence of distress, insolvency and, finally, failure. *Distress* is the situation in which the firm is increasingly unable to pay back its debts and gets nearer to insolvency. The term *distress* is associated with lack of liquidity due to high leverage or low profitability (Franks and Sussman, 2005; Opler and Titman, 1994). *Insolvency* is the inability of the firm to meet its current debts. The primary criterion to define *insolvency* is by relating net cash flows with current liabilities, while prior studies definition also considered assets-liabilities imbalance or working capital deficit (Altman and Hotchkiss, 2006; Gilson, 2010). Thus, *organizational decline*, *downward spiral*, *distress* and *insolvency* describe the turnaround *situation*. Since *insolvency* has been often used indistinctively with the term *bankruptcy*, it could also be classified as an *outcome*.

Strategic change is the conceptual framework under which turnaround strategies fall. It involves substantial shifts in the firm's policies, strategic scope, mission or organizational structure (Robbins and Pearce, 1992). Scholars have distinguished two groups of turnaround strategies: retrenchment and recovery, or repositioning (Boyne and Meier, 2009). *Restructuring* is employed as a synonymous word for turnaround (Pearce and Robbins, 2008). On the other hand, *downsizing* denotes an intended and planned action to reduce the firm's size in several ways, such as *retrenchment*, *downscaling* and *downscoping* (Dewitt, 1998; Muñoz-Bullón and Sánchez-Bueno, 2011; Winn, 1997). Finally, the terms *bankruptcy*, *recovery* and *failure* describe turnaround outcomes. While *bankruptcy* involves the inability to pay back debts[10], *recovery* is the desired outcome of a BT, in which the firm restores its prior performance. However, recovery can also present some graduations, from mere survival to a sharp growth (Trahms et al., 2013). *Failure* is an unsuccessful turnaround, either in terms of substandard performance recovery, or bankruptcy and liquidation. Table 1.1 gathers a summary of the described terms.

Table 1.1. Main business turnaround terms in prior studies.

Term	Definition	Turnaround stage
Organizational decline	A situation in which a substantial, absolute decrease in a firm's resource base occurs over a specified period of time.	Situation
Downward spiral	Decline worsens performance with time if the firm does not react to it. Poor performance self-reinforces, depletes firm's slack resources which further deteriorate performance leading a firm to failure.	Situation
Distress	Situation in which the firm is increasingly unable to meet its current obligations due to a lack of liquidity normally associated to high leverage or low profitability. It can be a temporary situation, not necessarily an irreversible one.	Situation

[10] In traditional turnaround research, bankruptcy and insolvency are used indistinctively. However, guided by Altman and Hotchkiss (2006), this research distinguishes between insolvent and bankrupt firms. Insolvent firms are those unable to meet their current liabilities, while bankrupt ones are insolvent firms that have filed for the formal procedure.

Insolvency	Firm inability to meet its current obligations due to a lack of liquidity. Technical insolvency compares net cash flows with liabilities maturities, rather than relating assets and liabilities or working capital.	Situation/Outcome
Strategic change	An intended shift in the firm strategic reorientation as a mean to adapt to external changes or performance problems.	Response
Turnaround strategies	Measures adopted by firms to stabilize and reverse a declining situation, also pursuing scaling back to profitability levels.	Response
Restructuring	A reactive change in firm strategy precipitated by poor performance. It is used as a synonymous of turnaround strategies.	Response
Retrenchment	The reduction of firm's costs and/or assets in order to increase cash generation and eliminate operational inefficiencies. It is also the stage in which performance decline stabilizes thanks to the measures adopted.	Response
Recovery	Measures pursuing the firm repositioning in profitable businesses and market niches. It is also the successful of a business turnaround, the one in which it fully restores or exceeds its prior performance levels.	Response/Outcome
Repositioning	Similar to recovery, these are the measures which aim at using the firm's resources and capabilities to enter new and profitable markets as a strategy to recover performance after a decline.	Response
Downsizing	Intended and planned firm resource reduction strategy whose aim is to increase efficiency (retrenchment), reduce output (downscaling) or reduce the variety in firm's activities (downscoping)	Response
Bankruptcy[11]	Traditionally, the death of the organization due to its inability for managers to control the firm and the impossibility for coalitions to achieve their goals.	Outcome
Failure	An unsuccessful turnaround, the one in which performance has not been restored or in which the firm needs to be sold or liquidated because its inability to recover.	Outcome

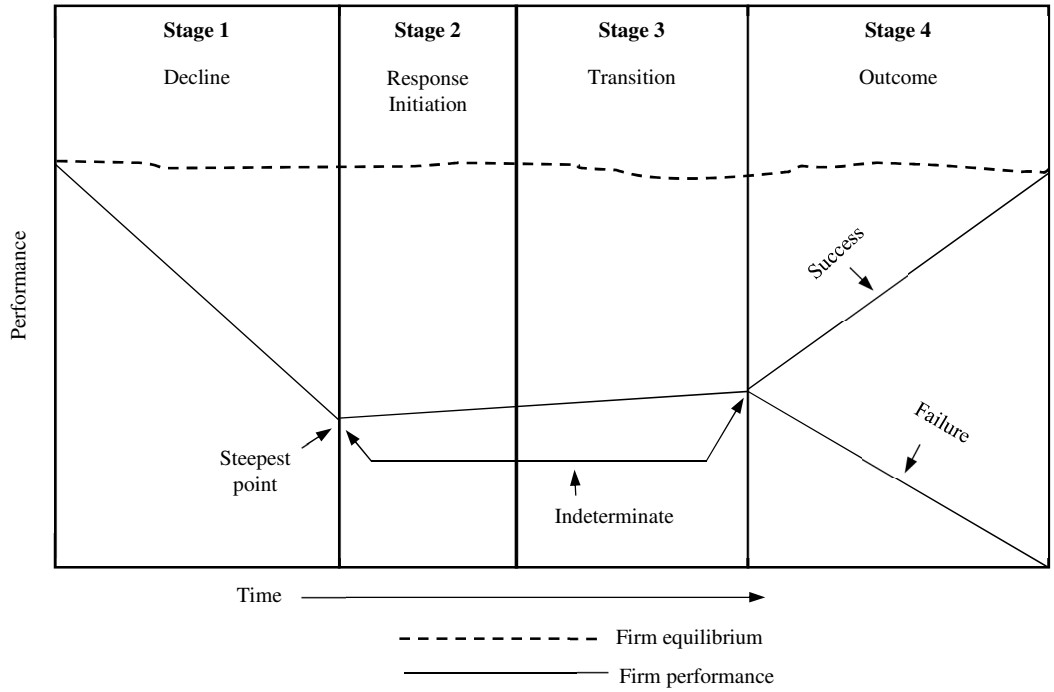
Source: Own elaboration.

[11] In this research, bankruptcy is the formal insolvency procedure, which not necessarily involves the firm's disappearance.

On the other hand, the turnaround *process*, firstly described by Chowdhury (2002), is based on the life-cycle family of process theory (Whetten, 1987), by categorizing the main elements of the process and how they evolve and trigger subsequent stages. Figure 1.2 illustrates the four stages proposed by the author, whose main determinants are the following:

1. Decline. Either external or internal causes (or both) result in the deterioration of the firm's financial performance and the level of resources. The starting point is equilibrium, but disbalances to such an extent that firm's performance reaches the steepest point. The speed of management reaction depends largely on when and how the crisis is perceived by organization's members and external stakeholders, which can put significant pressures for corrective measures to be adopted.
2. Response initiation. The steepest point of financial performance stimulates the adoption of actions in order to reverse decline. Breathing space is needed and mainly obtained by operating measures and aggressive cash raising strategies, such as retrenchment. The corporate governance could suffer significant shifts from management to creditors or employees, who may have a decisive influence in the turnaround actions to be adopted.
3. Transition. The length of this stage stands critical for the turnaround success, since actions could not provide immediate solutions for decline. The complex interaction between strategic, structure, culture, technology and human variables needs to be seriously addressed given the effects that curative actions can produce on them and their interplays.
4. Outcome. A cut-off point measure determines the degree of success or failure of the turnaround process, which needs to be measured in the same terms that was decline.

Figure 1.2. Chowdhury (2002) four-stages model.



Source: Chowdhury (2002).

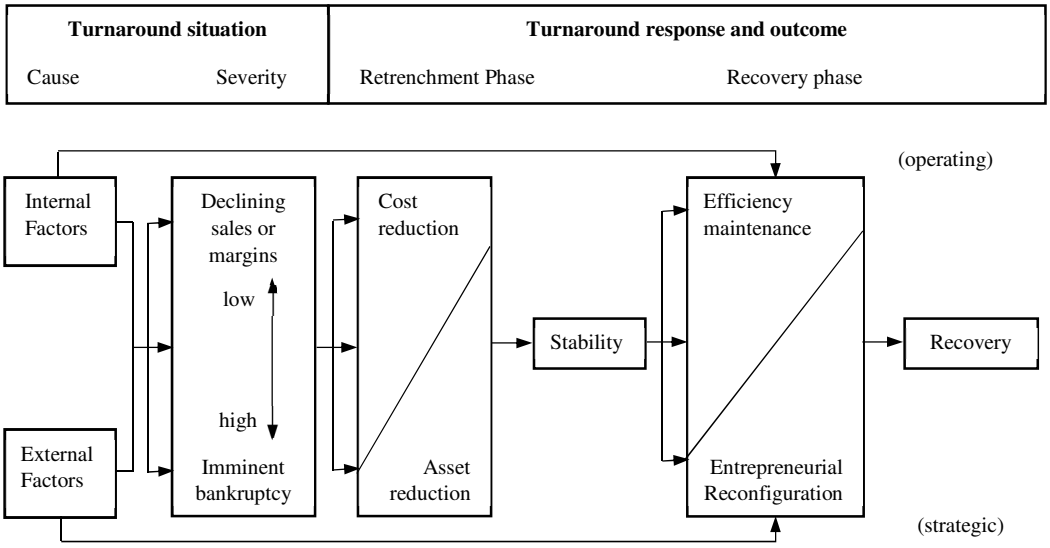
The main contribution of Chowdhury (2002) to turnaround literature is the inclusion of the transition stage, being the first author to take this stage into account. The inclusion of the transition phase is made on the assumption that the turnaround responses have no immediate effect, so a long period of time may pass before turnaround outcomes become visible. Despite that some prior scholars have hinted at the existence of this stage (Pant, 1991; Schendel et al. 1976), most studies have considered that turnaround responses and outcomes are almost simultaneous events (Chowdhury and Lang, 1996; Hambrick and Schecter, 1983; Robbins and Pearce, 1992; Schendel and Patton, 1976; Schmitt and Raisch, 2013).

Nonetheless, recent studies started introducing a time lag between the adoption of turnaround strategies and their outcomes, since some months or years are necessary to observe the actual impact of the responses (Boyne and Meier, 2009; Tangpong et al., 2015). This perspective thus implicitly acknowledges the existence of the transition stage.

1.1.2. Main research streams in the strategy aspect of turnaround.

The main stream of research in the strategy aspect of BT is the two-stage response model by Robbins and Pearce (1992), which describes the retrenchment-recovery process, strategies and outcomes (Figure 1.3). In the first stage, retrenchment, the firm aims at stabilizing decline by generating cash and eliminating inefficiencies through cost-cutting or asset selling measures. In the second stage, recovery, the firm reorientates its strategy towards profitable niches in order to restore prior performance. The recovery stage is only initiated when retrenchment has ended.

Figure 1.3. Robbins and Pearce (1992) - Pearce and Robbins (1993) model.



Source: Adapted from Robbins and Pearce (1992) and Pearce and Robbins (1993).

The authors have strongly supported the global validity of the model in subsequent studies (Pearce and Robbins, 1993; Pearce and Robbins, 1994; Pearce and Robbins, 2008) for all kinds of turnarounds. They found the existence of such commonalities, a two-stage process, in previous empirical and theoretical contributions to BT (Argenti, 1976; Bibeault, 1982; Hambrick and Schecter, 1983; Harrigan, 1980; Hofer, 1980; O'Neill, 1986b; Schendel and Patton, 1976; Schendel et al., 1976; Slatter, 1984). Their work, as well as the whole research field, is particularly influenced by Hofer (1980), who undertook a rigorous and thorough study of the main turnaround concerns and defined

many of the constructs that have been employed by subsequent authors. Hofer (1980) distinguished between "operational" and "strategic" turnarounds (similarly to retrenchment and recovery) and suggested the adoption of decided cutting actions to stabilize decline.

Building on the two-stage response model, subsequent turnaround scholars have introduced substantial nuances (Arogyaswamy et al., 1995; Lim et al., 2013; Morrow et al., 2004; Schmitt and Raisch, 2013; Tangpong et al., 2015), proposed the existence of additional stages (Filatotchev and Toms, 2006) or even confronted it (Barker and Mone, 1994). Two main arguments have arisen against the global effectiveness of the two-stage model. In first place, it has been suggested that retrenchment, instead of being a voluntary action *per se*, it is a consequence of decline (Barker and Mone, 1994). The idea has strong theoretical support from the organizational decline literature (Cameron et al., 1987a; Cameron et al., 1987b; Cameron et al., 1988; Weitzel and Jonsson, 1989) which suggests that the choice of wrong retrenchment approaches can further push a firm into decline. However, successive studies have proved that retrenchment is normally an intended strategy in the majority of turnarounds (Boyne and Meier, 2009).

The second argument is that the two-stage model has no whole validity for all turnarounds. Most authors assume the turnaround process as proposed by Pearce and Robbins (1992), but several studies have challenged the general assertion proposed by the two-stage model that retrenchment is necessary whatever the cause of decline. The argument of Robbins and Pearce (1992) has the flaw that their study was conducted in a context of declining firms in a mature industry (textile mills) in the USA. Posterior studies have shown that retrenchment has no general effectiveness when adopted in different industries with different growth levels (Morrow et al., 2004) or in different contexts (Castrogiovanni and Bruton, 2000). Also, when studied in different countries (Bruton et al., 2003; Gowen and Tallon, 2002; Lim et al., 2013) has retrenchment shown a variety of results not coincident with the general paradigm.

1.1.3. Theories and frameworks adopted in turnaround research.

BT has suffered a lack of strong theoretical guidance, since prior investigations have largely been *ad hoc* and have generally not benefited from relevant and potentially fecund extant theory (Pandit, 2000). However, as time has passed, recent studies have been gaining theoretical strength given the relative long life of the research field. As part of the organizational change theory, the main contributions from business and management fields are the organizational decline, the resource-based view (RBV), downward spirals, financial distress, threat-rigidity response, agency theory, prospect theory and upper echelons. Those theories and their application to business turnaround are summarized in Table 1.2.

Table 1.2. Main theories in business turnaround research.

Theories/constructs	Definition	Applied studies
Organizational decline	The last stage of organizational life cycle, in which the firm losses a substantial base of resources when the firm is unable to avoid or adapt to internal or external pressures that threat its survival	Cameron et al., (1987a); Whetten (1987); Cameron et al., (1988); Weitzel and Jonsson (1989); D'Aveni (1989a); Van Witteloostuijn (1998); Chowdhury (2002); Sheppard and Chowdhury (2005); Tangpong et al. (2015)
Bankruptcy	The death of the organization, since managers lose control of the firm and involved coalitions do not achieve any of their goals.	Daily (1994); Daily and Dalton (1994a); Daily and Dalton (1994b); Daily (1995); Daily and Dalton (1995); Daily (1996); Sheppard (1994); Barker and Duhaime (1997); Sheppard and Chowdhury (2005)
Resource-based view	Failed turnarounds can be explained by the lack of several resources and capabilities, as well as the existence of strategic liabilities.	Ruiz-Navarro (1998); Thornhill and Amit (2003); Arend (2004); Arend (2008); Cook et al. (2011); Lim et al. (2013)
Downward spirals	In a decline, the firm suffers several effects that may increase the threat of disappearance, such as talented employees leaving, threat-rigidity responses, vacillation, slack and performance deterioration.	Hambrick and D'Aveni (1988); Weitzel and Jonsson (1989); Rudolph and Repenning (2002); McKinley et al. (2014); Tanpong et al. (2015); Barbero et al. (2017)

Distress	A situation in which the firm is increasingly unable to meet its current obligations due to a lack of liquidity. It can be temporary rather than irreversible	Altman (1969); Robbins and Pearce (1992); Bruton et al. (1994); Routledge and Gadenne (2002); Franks and Sussman (2005); Altman and Hotchkiss (2006)
Path-dependence pattern	A set of dynamic processes in which actions and events can unintendedly trigger a self-reinforcing cycle which carry lasting consequences that subsequent actions can only modify only to a limited extent.	Rudolph and Repenning (2002); Garud et al., (2010); Tangpong et al. (2015); Barbero et al. (2017)
Threat-rigidity response	A mechanistic response by managers of firms suffering decline. They are characterized by increase of control, information restriction, and exclusive focus on efficiency increase.	Hambrick and D'Aveni (1988); D'Aveni and MacMillan (1990); Hambrick and D'Aveni (1992); Barker and Mone (1998); Ketchen and Palmer (1999); Musteen et al., (2011); O'Kane and Cunningham (2014)
Agency theory	Firm failure or bankruptcy are the result of a lack of organizational legitimacy with its exchange partners due to organizational decline.	Pfeffer and Salancik (1978); D'Aveni (1989a); Gilson (1990); Johnson (1996); Pajunen (2006); Filatotchev and Toms (2006); Higgins et al. (2015)
Prospect theory	When a firm declines to a minimum acceptable level of resources, the creditors may decide whether to induce the firm to bankruptcy or assume the risk of future recovery	D'Aveni (1989a); D'Aveni (1989b); Arogyaswamy et al. (1995)
Upper echelons	The structure of board and TMT characteristics of firms attempting turnaround determines the likelihood of success	Daily (1995); Mueller and Barker (1997); Barker and Mone (1998); Barker and Barr (2002); Chen and Hambrick (2012); Chen (2015); Abebe et al. (2012; Abebe and Tangpong (2018).

Source: Own elaboration.

The predominant theory in BT is organizational decline, whose origin is the organizational life-cycle. Subsequent developments have extended the organizational decline framework, mainly through the description of downward spirals and the path-dependent pattern. In conjunction with agency and prospect

theories as well as the RBV and upper echelons theory, all of them account for more than 90% of research studies in the business turnaround field.

Organizational decline

Organizational decline literature has focused on investigating the process of firm's decline within its life-cycle (Miller and Friesen, 1984). Weitzel and Jonsson (1989) described the existence of five stages in a decline: (1) the firm is blind to the early stages of decline, (2) the firm recognizes the need for organizational change bur takes no action, (3) the takes action, but the action is inappropriate, (4) the firm reaches a point of crisis and (5) the firm is forced to liquidate. In case that the firm do not take proper actions during such process, decline would unstoppably continue its path, unfolding additional organizational struggles as well as aggravating the self-reinforcing cycle.

Such process, known as a downward spiral (Hambrick and D'Aveni, 1988), is characterized by the firm vacillating trend. Internal climate deteriorates, decision-making processes become restrained and opaque and slack resources disappear. One of the most studied consequences of decline the is the threat-rigidity response of managers (Hambrick and D'Aveni, 1988; D'Aveni and MacMillan, 1990). While the behavioral theory of the firm (Cyert and March, 1963) proposes that a declining firm will respond decidedly to poor performance, the threat-rigidity perspective defines the mechanistic shift process in the way of managing the firm, centralizing control, restraining information and a strong focus on efficiency actions (Ketchen and Palmer, 1999).

The most recent turnaround studies have built on the path-dependent pattern of the declining process (Barbero et al., 2017; Tangpong et al., 2015). Given the self-reinforcing nature of decline, the inaction, late action or inadequate action have lasting consequences for the firm's recovery potential.

Agency theory

Agency theory (Fama and Jensen, 1983) has helped turnaround scholars to explain success or failure as a function of its relationships' health with stakeholders. D'Aveni (1989a) developed his "dependability" model as a

function of internal and external resources, one of which was managers' reputation within stakeholder. If not attained the "dependability" level, the firm is not legitimate to continue operating, and thus stakeholders withdraw their support and must decide whether (1) force the firm into bankruptcy or (2) delay the bankruptcy in the expectation of future recovery.

Arogyaswamy et al. (1995) suggested that, along with efficiency measures, the firm should enhance relationships with stakeholders. Later turnaround scholars explain the relevance of stakeholders in both organizational survival in firms attempting turnarounds (Pajunen, 2006) and financial constraints on strategic turnarounds (Filatotchev and Toms, 2006). Pajunen (2006) focused on the shifts which suffered the stakeholders' weight during decline, while Filatotchev and Toms (2006) addressed the need to realign stakeholders and firm's expectations if the turnaround was to be successful. Both studies highlight the importance of regaining stakeholders support before entering the stabilization stage (retrenchment).

Prospect theory

Prospect theory argues how individuals make decisions under conditions of uncertainty. The development of prospect theory (Kahneman and Tversky, 1979) has provided business turnaround research with substantial insights to third-parties reaction to a firm's decline. D'Aveni (1989a) shows the loss aversion attitude of creditors when facing "undependable" firms. Given that a loss is twice as much as valued as a gain, creditors are "loss averse" and usually decide to delay forcing the declining firm into bankruptcy.

The resource-based view

The resource-based view focuses on how firms obtain sustained competitive advantages (Barney, 1991; Barney et al., 2011; Penrose, 1959; Peteraf, 1993; Wernefelt, 1984), arguing that valuable, rare and imperfectly imitable resources, for which there are not available strategically equivalent substitutes, were the source for such advantages. In the business turnaround field, Scholars have argued that the "liability of newness" stood true for declining firms (Thornhill and Amit, 2003).

Additionally, turnaround strategies, specifically retrenchment, had unequal effectiveness depending on the main source of competitive advantage, either Schumpeterian or Ricardian (Lim et al., 2013).

Upper echelons theory

Upper echelons theory suggests that organizational performance is determined partially by managers' background and characteristics (Hambrick and Mason, 1984). Turnaround scholars have predicted the turnaround outcome as a function of the managerial attributions of TMTs from declining firms (Chen and Hambrick, 2012; Mueller and Barker, 1997). This theory has also helped to explain the common measure of changing incumbent managers in turnaround situations (Abebe and Tangpong, 2018; Chen, 2015).

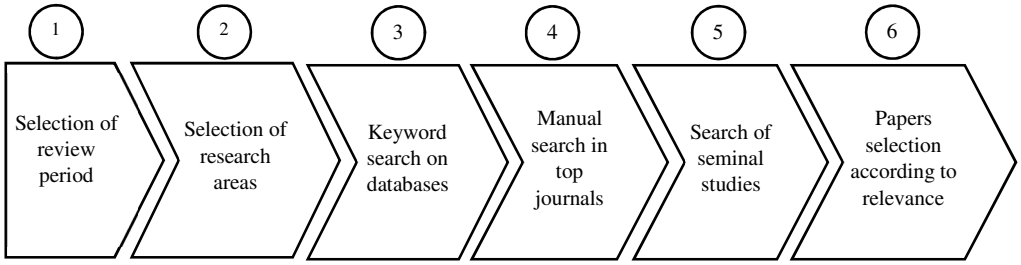
1.2. Review of the extant literature.

A preliminary analysis for reviewing the extant literature in business turnaround was undertook. The aim was to know the current situation of the research field as well as the contributions made by prior studies on BT, particularly regarding the effectiveness of turnaround strategies in declining firms. The whole review process is described in the following subsections.

1.2.1. Review methodology.

Similar to Schweizer and Nienhaus (2017), a review of the issue following the six-step approach from Brauer (2006) and Haleblian et al. (2009) was conducted. Firstly, the reviewed period was extended from 1992 to 2017, given that the Great Recession has brought new interest in the matter. Accordingly, it was expected that a jump in turnaround and bankruptcy publications will take place in recent years. Second, the business and management research areas were selected. Thirdly, the keyword search was conducted through the databases Web of Science, SCOPUS and Google Scholar. The main keywords spanned were: *bankrupt*, crisis, decline, default, distress*, divest*, reorganization, restruct*, survival* and *turnaround*. It were also added the following concepts to the selected keywords: *insolven**, *liquidation*, *recovery*, and *retrench**. Fourth, a manual search by issue of the 10 top journals was conducted: *Academy of Management Journal, Administrative Science Quarterly, Journal of Business Research, Journal of Management, Journal of Management Studies, Long Range Planning, Management Science, Organization Science, Organization Studies* and *Strategic Management Journal*. Fifth, the seminal studies prior to 1992 were located, such as Altman (1968). In sixth and last step, those works were screened in more detail and were prioritized according to relevance. The final sample resulted in 161 papers from 10 journals. The search method and review methodology is depicted in Figure 1.4.

Figure 1.4. Literature review methodology



Source: Adapted from Schweizer and Nienhaus (2017)

1.2.2. Review results.

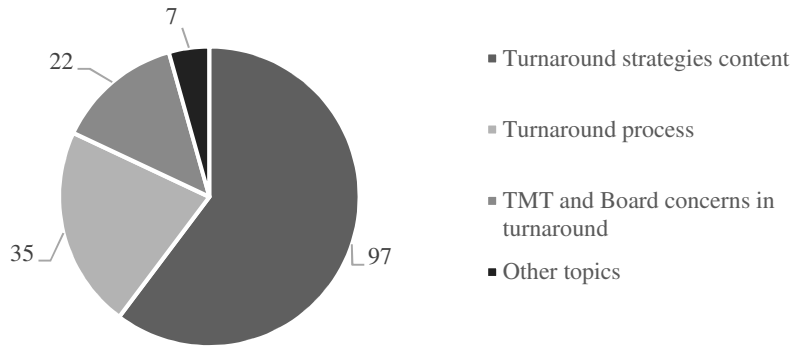
A total 161 papers were collected from selected journals. Table 1.3 reports the journal distribution of the publications, from which 147 are empirical studies. The main research issues have been the *turnaround strategies content*, which amounts 97 papers (60.2%), while the *turnaround process* accounts for 35 studies (21.7%), the *TMT and Board concerns* when attempting turnaround add up to 22 papers (13.7%). Other topics in business turnaround amount 7 papers (4.7%). The paper distribution by topics is shown in Figure 1.5. Additionally, publications in the business turnaround field have significantly increased since the end of the Great Recession (2013) and have overcome the prior peak of 1992 (Figure 1.6). It can be stated that adverse macroeconomic conditions and its consequences for firms are clearly linked to publication frequency regarding turnaround.

Table 1.3. Publications (1992 – 2017) in business turnaround research of 10-top journals.

Journal	Publications	Empirical studies
Strategic Management Journal	32	30
Journal of Business Research	30	30
Long Range Planning	27	24
Organization Science	17	15
Management Science	15	14
Journal of Management Studies	13	10
Journal of Management	11	9
Academy of Management Journal	8	7
Administrative Science Quarterly	4	4
Organization Studies	4	4
Total	**161**	**147**

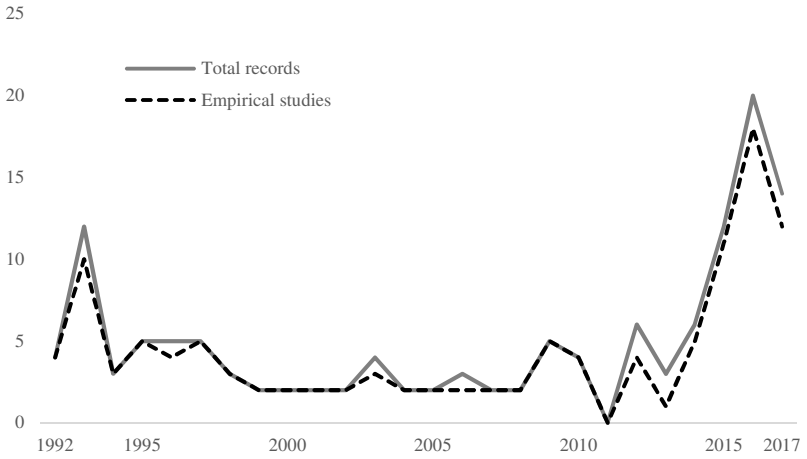
Source: Own elaboration.

Figure 1.5. Publication distribution in terms of research areas.



Source: Own elaboration.

Figure 1.6. Publications distribution per year.



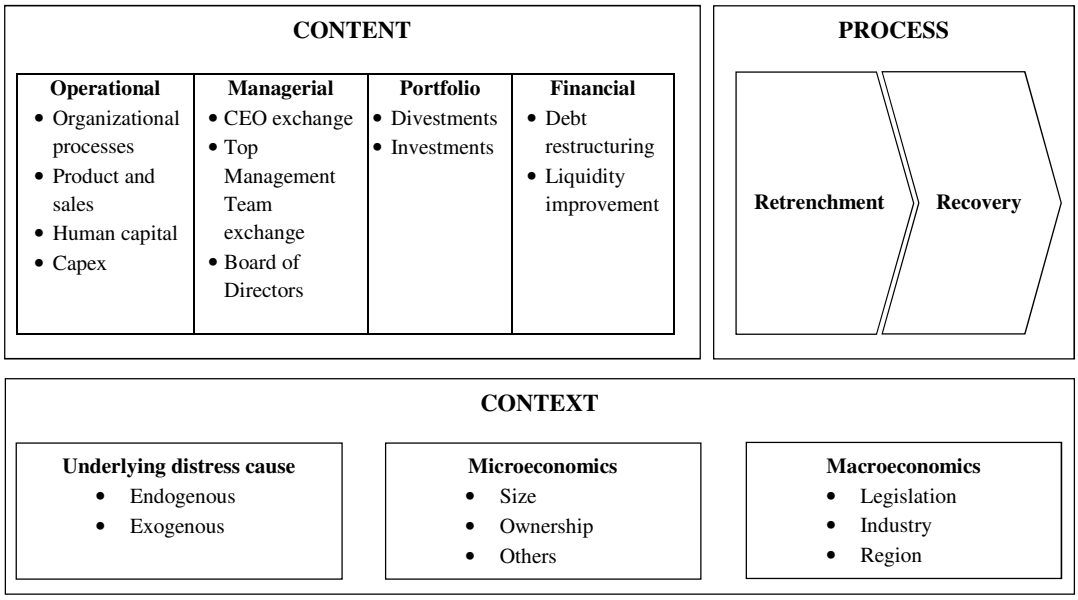
Source: Own elaboration.

Determinants of a business turnaround outcome.

An important number of determinants in a BT have been accounted for by prior scholars. Building on the whole turnaround process and its main constructs (situation, response and outcomes), Schweizer and Nienhaus (2017) proposed a comprehensive conceptual framework that embraces all the aspects of the process. The authors gathered studies not exclusively from management, but also from the fields of accounting, economics, sociology and finance. The result is shown in Figure 1.7. The conceptual framework integrates organizational change with BT research to account for the various sides and actions a firm goes through when reacting to decline.

The organizational change theory provides a division between content, process and context research. Within the *content* area, the actions and strategies adopted by declining firms are collected, the "what" form of a turnaround (Lim et al., 2013). The organizational process is contemplated under *process*, or "how" the firm attempts survival in critical situations. Finally, the "why" of change is defined in the inner and outer *context* of the declining firms (Pandit, 2000). Accordingly, the main determinants studied in turnaround research are those related to the *content*, *process* and *context*.

Figure 1.7. Schweizer and Nienhaus (2017) turnaround-distress framework.



Source: Schweizer and Nienhaus (2017).

The content of a BT integrates the set of particular actions that a firm could take to reverse decline and survive or recover performance. Most of them relate to the retrenchment stage, in which the aim is to stabilize decline, raise cash and assure the firm's survival, at least in the short and middle term (Robbins and Pearce, 1992). Several actions during downturn have proved to be more effective in the retrenchment stage, such as organizational processes change; capital expenditures (capex) savings, CEO and TMT exchange or strategic divestments. Strategic reorientation or innovation are advised once stability has been attained (Barker and Duhaime, 1997) and will require innovative solutions or the strategic reorientation or refocusing (see Table 1.4).

Table 1.4. Content determinants of business turnaround.

Content of turnaround	Potential determinants	Main studies	Main theories	Turnaround strategy
Operational	Organizational processes	Hofer (1980); Hotchkiss (1995); Ketchen and Palmer (1999); Routledge and Gadenne (2000); Sudarsanam and Lai (2001).	Organizational decline	Retrenchment
	Product and sales	Stopford and Baden-Fuller (1990); Van Witteloostuijn (1998).	Organizational decline, RBV	Innovation
	Human capital	Chowdhury and Lang (1996); Guthrie and Datta (2008); Love and Kraatz (2009); Datta et al. (2010); Santana et al. (2017)	Organizational decline, downward spirals, threat-rigidity response	Downsizing, human resource management
	Capex	D'Aveni (1989a); Moulton et al. (1996); Sudarsanam and Lai (2001); Campello et al. (2010)	Organizational decline	Retrenchment
Managerial	CEO Exchange	Daily and Dalton (1995); Hotchkiss (1995); O'Kane and Cunningham (2014)	Organizational decline, downward spirals, threat-rigidity response	Replacement
	TMT exchange	Daily and Dalton (1994); Mueller and Barker (1997); Barker et al. (2001); Lohrke et al. (2004);	Organizational decline, downward spirals, threat-rigidity response, upper echelons	Replacement
	Board of Directors	Daily and Dalton (1994); Daily (1995); Daily and Dalton (1995); Boyne and Meier (2009); Chen and Hambrick (2012)	Organizational decline, downward spirals, threat-rigidity response, upper echelons	Introduce externals directors
Portfolio	Divestments	Robbins and Pearce (1992); Lamont et al. (1994); Winn (1997); Morrow et al. (2004). Mann and Byun (2017)	Organizational decline, RBV	Retrenchment, focus on core business
	Investments	Morrow et al. (2007); Eichner (2010)	Organizational decline, RBV	Strategic reorientation, refocusing
Financial	Debt restructuring	D'Aveni (1989a); Sheppard (1994); Winn (1997); Routledge and Gadenne (2002); Kahl (2002)	Organizational decline, RBV, agency theory, prospect theory	Retrenchment
	Liquidity improvement	Chowdhury and Lang (1996); Castrogiovanni and Bruton (2000)	Organizational decline, RBV	Retrenchment

Source: Own elaboration.

Prior turnaround scholars have paid specific attention to the turnaround process development. Previous studies have implicitly or explicitly acknowledged the existence of a two-stage process (Robbins and Pearce, 1992). Other authors have included additional stages, such as realignment (Filatotchev and Toms, 2006) or transition (Chowdhury, 2002), but the essence has remained solid. The sequence of the turnaround has been largely discussed in the literature, specifically regarding the need to go through the retrenchment stage regardless of the *nature* of the turnaround (operating or strategic) and the focus on recovery actions. Most of authors have proved that the retrenchment stage is necessary, but results are not homogeneous, given the variety of contexts, industries, or degree of severity (Morrow et al., 2004; Morrow et al., 2007; Ndofor et al., 2013). Discussion on the effectiveness of retrenchment remains vivid and, as Lim et al. (2013:42) state: "…little is known about when, how, and in what form retrenchment should be used". Despite this lack of knowledge, retrenchment is the most common turnaround strategy (Barbero et al., 2017; Santana et al., 2017).

Conversely, strategic initiatives to overcome turnaround had strong support as a means to obtains sustainable profits recovery (Barker and Duhaime, 1997; Ndofor et al., 2013). Declines whose main cause was poor strategic positioning mainly required recovery or strategic measures rather than retrenchment ones, which might be even detrimental for the firm's performance (Ndofor et al., 2013). Additionally, building on the RBV and the *exploitation* and *exploration* abilities, Schmitt and Raisch (2013) found that the combination and overlapping of the retrenchment and recovery stages could provide positive and enhanced results, attending to the reinforcing effects that produce contradicting strategies. Nonetheless, the authors also found that such finding was not valid for firms which were suffering a severe decline. It seems that the lack of resources poses a limit on the ability to combine both stages (see Table 1.5). Thus, additional support was given to the two-stage model and its sequencing of the BT process.

Table 1.5. Process determinants of business turnaround.

Process of turnaround	Potential determinants	Main studies	Main theories	Predicted outcome
Process	Timing and sequences	Hambrick and Schecter (1983); Finkin (1985); Hoffman (1989); Arogyaswamy et al. (1995); Chowdhury (2002); Filatotchev and Toms (2006); Lohrke et al. (2012); Schmitt and Raisch (2013); Tangpong et al. (2015).	Organizational decline, downward spirals, threat-rigidity response, agency theory, prospect theory, path-dependent pattern, RBV.	Retrenchment-recovery process
Retrenchment	Cutting actions regardless of the kind of turnaround	Robbins and Pearce (1992); Barker and Mone (1994); Lamont et al. (1994); Chowdhury and Lang (1996); Michael and Robbins (1998); Castrogiovanni and Bruton (2000); Schmitt and Raisch (2013), Lim et al. (2013); Tangpong et al. (2015).	Organizational decline, downward spirals, path-dependent pattern	First necessary stage retrenchment, once stability attained, recovery.
Recovery	Focus on entrepreneurial actions when causes are external	Hofer (1980); Finkin (1985); Barker and Duhaime (1997); Pandit (2000); Sudarsanam and Lai (2001); Eichner (2010)	Organizational decline, downward spirals, path-dependent pattern, RBV	Recovery actions

Source: Own elaboration.

With respect to the contextual determinants of BT, they have been explored reasonably thoroughly and conclusions are well-grounded. Table 1.6 reports these ideas. There is consensus that the causes of decline shape the suitability of responses. In particular, when the predominant causes of decline are internal, retrenchment strategies have proved more effective, while in case of major external causes the strategic reorientation and recovery actions are recommended. Microeconomic factors such as size and ownership accounted for determining to a certain extent the turnaround outcome. It is also established that size matters when attempting turnarounds, since larger firms have higher probability to success given their wider resource base (Cook et al., 2011; Thornhill and Amit, 2003)

Ownership or, in a wider aspect, predominant stakeholders, determine which strategies are adopted, which will respond to the main coalition's interests and not necessarily to those that provide a higher likelihood of survival

(Filatotchev and Toms, 2006). Finally, macroeconomic aspects have been also studied. Legislation is a growing body of research, given the direct influence it has for firms falling in restructuring, turnaround or bankruptcy. The importance of industry has been tested, particularly contrasting mature ones, in which focus must be focused on retrenchment actions due to over-capacity, and growing ones, in which innovation and entrepreneurial actions are key to success (Morrow et al., 2004; Ndofor et al., 2013). Rarely have different regions from the USA or UK been studied in turnaround research. However, in studies within varied regions the outcomes of turnaround have shown particularities explained by the cultural background of the country in particular (Bruton et al., 2003; Lim et al., 2013).

Table 1.6. Context determinants of business turnaround.

Context factor	Potential determinants	Main studies	Main theories	Predicted outcome
Causes of decline	Internal	Hofer (1980); Francis and Desai (2005)	Organizational decline, downward spirals	Retrenchment effectiveness
	External	Meyer (1982); Barker and Duhaime (1997); Pearce and Michael (2006); Benmelech and Bergman (2011)	Organizational decline	Strategic reorientation, recovery
Microeconomics	Size	Pant (1991); Moulton and Thomas (1993); Thornhill and Amit (2003)	RBV	Advantage of larger firms
	Ownership	Mordaunt and Cornforth (2004); Boyne (2004); Jas and Skelcher (2005); Filatotchev and Toms (2006); Boyne and Meier (2009); Paton and Mordaunt (2010)	Upper echelons, agency theory, prospect theory	Ownership determines strategies to be adopted.
	Others	Cater and Schwab (2008)	RBV	Family firms are more resilient to decline
Macroeconomics	Legislation	Davydenko and Franks (2008); López-Gutiérrez et al. (2012); García-Posada and Vegas (2016)	Institutional theory	Ex post vs ex ante efficiency determined by institutional framework
	Industry	Pant (1991); Dewitt (1998); Routledge and Gadenne (2002); Morrow et al. (2004); Ndofor et al. (2013).	RBV, contingency framework of turnaround	Industry shapes suitable response
	Region	Bruton et al. (2003); Schmitt and Raisch (2013)	Cultural traditions	Culture and territory influence the outcome

Source: Own elaboration.

Sample contexts.

As found by Schweizer and Nienhaus (2017) there is a clear bias towards Anglo-Saxon firms, specifically American ones (138 out of 147 in our journals' sample), given that vast the majority of empirical studies have been conducted by US scholars. Japanese (Lim et al., 2013), Chinese (Bruton et al., 2003), Spanish (Ruiz-Navarro, 1998), Finnish (Pajunen, 2006), Austrian, German and Swiss (Schmitt and Raisch, 2013) are the rest of countries studies within the main journals. Other reviewed journals, but not included in the top 10, have also focused on British firms (Cook et al., 2011; Pandit, 1998; Pandit et al., 2000; Sudarsanam and Lai, 2001; Wild, 2010; Wild and Lockett, 2016).

Prior turnaround studies have neglected studying turnaround strategies in the bankruptcy context, except for Collet et al. (2014). These authors used a sample of Finnish SMEs attempting turnaround within the Finnish Restructuring of Enterprises Act, the equivalent to the bankruptcy procedure. Bankrupt firms have traditionally been employed as the failed outcome to measure strategic actions in matched samples studies (Altman, 1968; D'Aveni, 1989a; D'Aveni, 1989b; Daily, 1994; Daily, 1995; Daily and Dalton, 1994a; Daily and Dalton, 1995; Hambrick and D'Aveni, 1988; Hambrick and D'Aveni, 1992; Thornhill and Amit, 2003). Rather than a context in which investigate, bankruptcy has been regarded as the *end* of the firm, the one that signals its disappearance and complete failure (Sheppard and Chowdhury, 2005).

As far as it is known, only three turnaround empirical studies have employed Spanish firms and two of them (Ruiz-Navarro, 1998; Zúñiga-Vicente and Vicente-Lorente, 2006) are included in the sample of top 10 journals. Ruiz-Navarro (1998) conducted a qualitative analysis of the turnaround in the Bazan Shipyard, describing the whole turnaround process. Zúñiga-Vicente and Vicente-Lorente (2006) addressed the strategic moves and organizational survival among the Spanish banks during the 1983-97 period. Finally, in the study of Pla-Barber et al. (2007) and the thesis by Toral-Pla (2010) a sample of Spanish SME's from the textile industry were used to analyze the adoption of turnaround strategies.

Other bankruptcy-related studies have been directed within the Spanish scope (Aguiar-Díaz y Ruiz-Aguilar, 2013; Camacho-Miñano et al., 2015; Fernández, 2004; García-Posada and Mora-Sanguinetti, 2012; García-Posada and Vegas, 2016; López-Gutiérrez et al., 2012; López-Gutiérrez et al., 2015; Madrid-Guijarro et al., 2011; Van Hemmen, 2009), though none of them addresses the strategic aspects within bankruptcy.

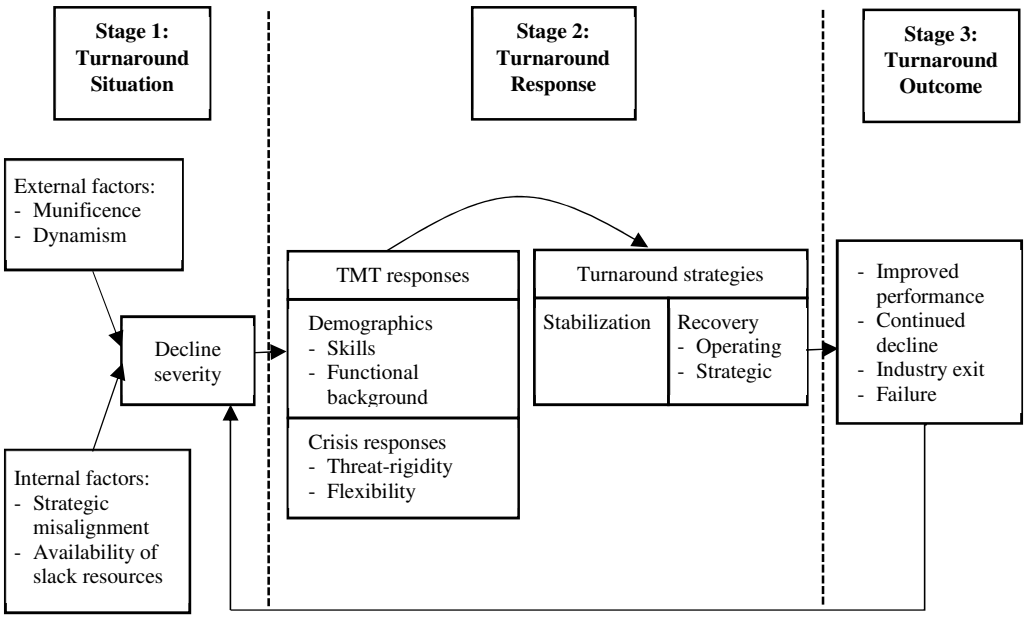
1.3. Main issues in the effectiveness of turnaround strategies.

BT has been traditionally studied on the basis of the turnaround process, which unfolds in three related stages: (1) the turnaround *situation*, (2) the turnaround *response* and (3) the turnaround *outcome* (Lohrke et al., 2004). By comparison, the two-stage model by Robbins and Pearce (1992), overlaps the turnaround responses (retrenchment and recovery) and the turnaround outcome. In the Robbins and Pearce (1992) model, the turnaround outcome referred as *recovery*, the same term than the second-stage response.

However, for clarity's sake it was chosen to structure the explanation of the turnaround process on the basis of Lohrke et al. (2004), which implicitly integrates the two-stage model. As shown in Figure 1.8, when a firm suffers a decline and its viability of a firm is under threat, it finds itself in a "turnaround situation", also called distress. The causes of decline could be due to environmental variations, internal failures, or a combination of both (Pearce and Robbins, 1993). The measures adopted by firms whose survival is put in doubt by either the economic conditions or inner struggles, and which may permit their continuity, are called "turnaround responses" or "turnaround strategies" (Trahms et al., 2013).

Turnaround strategies are implemented in two stages: retrenchment and recovery. (Robbins and Pearce, 1992; Barker and Mone, 1994). Retrenchment strategies focus on the stabilization of decline and correction of operational inefficiencies (Bibeault, 1982; Hambrick and Schecter, 1983; Hofer, 1980; Robbins and Pearce, 1992), while recovery strategies aim to reorientate the corporate strategy towards a profitable path (Barker and Duhaime, 1997). The strategies adopted during the turnaround process need to respond to the main cause of decline, either internal or external. Consequently, they are classified in two groups: operating and strategic (Hofer, 1980). In case that internal causes are predominant operating strategies should be adopted, while external causes require a realignment with demand, so entrepreneurial and strategic reorientation will be the cure to decline.

Figure 1.8. The business turnaround process.



Source: Lohrke et al. (2004).

Additionally, Pandit (2000) suggested that, in high severity situations, the purpose of a turnaround could be the mere survival of the firm, attaining an economic performance acceptable to the firm's stakeholders. This last definition is better aligned with the purpose of this research, since the main objective of bankrupt firms is achieving survival, while improving performance is put on a second level. Finally, the result of the actions implemented is called the "turnaround outcome", which can range from a real improvement in performance to a complete failure (Lohrke et al., 2004).

A complete BT embraces the diagnosis, the actions and the final result of the turnaround situation (Slatter and Lovett, 1999). Despite that the focus of this research is put on the effectiveness of turnaround strategies in a context of severe decline (bankruptcy), a review of the whole process is also provided. Consequently, this review considers (1) the definition and operationalization of decline and the turnaround situation, (2) the effect of the causes of decline on turnaround strategies, (3) the severity of decline, (4) the content of turnaround, (5) the role of stakeholders and (6) the path-dependent nature of the process.

1.3.1. Definition and operationalization of decline, turnaround situation and turnaround outcome.

Pandit (2000) suggested that misunderstandings and equivocal results in prior research are due to a lack of a common definition of a BT and its related concepts, situation and outcomes.

In first place, previous scholars grounded their definitions of a turnaround situation on the organizational decline literature, assuming that it occurs when the firm suffers a threatening decline. One of the most widely accepted definitions of decline is the proposed by Cameron et al. (1987a: 224): "Organizational decline is a condition in which a substantial, absolute decrease in an organization's resources base occurs over a specified period of time". In a subsequent definition, Cameron et al. (1988) reconsidered their statement by acknowledging the existence of both internal and external sources of decline, a conceptualization that remains well accepted (Francis and Desai, 2005; McKinley et al., 2014; Robbins and Pearce, 1992).

Arogyaswamy et al. (1995: 497) focused their definition of a turnaround situation acknowledging the existence of decline, as "one where a firm suffers declining economic performance for an extended period of time, […] and the actual level of the firm performance is low enough that the survival of the firm would be threatened without performance improvement". The authors suggested that firms in a turnaround situation suffer sustained resource losses that will lead to the firm failure if not corrected. This idea (loss of resource base) remains different from "stagnation", a situation under which firms have not the pressure to survive present in a turnaround situation (Grinyer and McKiernan, 1990). "Distress" is usually employed as a synonymous of a turnaround situation, but Altman and Hotchkiss (2006) recognize that, unlike turnaround, distress could be a temporary situation corrected by uncontrollable factors.

All in all, a clear, simple and comprehensive definition of a turnaround situation is the one suggested by Pandit (2000), who recommends that "…turnaround candidates are firms whose very existence is threatened unless radical action is taken…" (Pandit, 2000: 37). This is the case for bankrupt firms,

which find themselves in an all-or-nothing situation if no decided measures are adopted to reverse it.

In second place, the turnaround *outcome* (success or failure in all their varieties) have been normally measured through performance indicators. Barker and Duhaime (1997: 18) asserted that a turnaround success occurs "when a firm undergoes a survival-threatening decline over a period of years but is able to reverse the performance decline, end the threat to firm survival and achieve substantial profitability". Nonetheless, this definition poses some doubts on the timing, since firms can decline rapidly and be equally threatened in their continuity, and on the measurement of success, by requiring a substantial profitability. Similarly, Sudarsanam and Lai (2001) suggest that a successful turnaround is reached in case that pre-decline performance is achieved after the adoption of turnaround strategies.

In contrast, Balgobin and Pandit (2001) consider that successful turnarounds occur in two ways. In its most soft form, it may involve the mere survival with a certain level of economic performance only just satisfactory to the firm's stakeholders. Conversely, a completely successful turnaround would imply that the firm achieves sustainable, greater competitive positions in its business. Pandit (2000: 32) defines a complete business turnaround in the following terms:

> "A business turnaround may be defined simply as the recovery of a firm's economic performance following an existence-threatening decline. The decline may occur over several years although there are situations when extraordinary events occurring over a shorter period of time can place a firm in peril."

That statement conceals better with the purpose of this research, and it also establishes a conceptual framework under which classify bankrupt firms. Additionally, Pandit (2000) suggests that a successful turnaround can be the mere survival of the firm, with no requirements of a specific level of performance restoration. Identifying turnaround on the basis of accounting measures is also unacceptable, given the possibility of manipulation in declining performance contexts (Probst and Raisch, 2005). The proposed alternative is to

triangulate that seeks agreement among financial profitability indicators and expert opinions (Pandit, 2000). This approach is better aligned with bankruptcy contexts, where there is no doubt that survival is under threat and also the urgency and speed of acting remains key to success, regardless of the profitability recovery, at least in the short-term.

Finally, prior turnaround research has focused on performance measures: earnings, growth in income, return on investment (ROI), return on sales (ROS) or profit before taxes. They were captured either isolated or compared to relevant economic or industry indicators such as gross national product (GNP) growth, industry averages of ROI or ROS, cost of financing or cost of equity and risk-free rate (Barker and Duhaime, 1997; Bibeault, 1982; Bruton et al., 2003; Chen and Hambrick, 2012; Hambrick and Schecter, 1983; Morrow et al., 2004; Robbins and Pearce, 1992; Schendel and Patton, 1976; Schendel et al., 1976; Tangpong et al., 2015). Table 1.7 gathers the operationalization of the turnaround situation and success in relevant prior studies.

Table 1.7. Operationalization of turnaround in relevant prior studies.

Authors	Turnaround situation	Turnaround success
Schendel et al. (1976)	Four consecutive years of earnings decline	Four consecutive years of earnings improvement
Schendel and Patton (1976)	At least four years of sub-GNP growth in income	At least four years of above-GNP growth in income
Bibeault (1982)	At least three years of sustained but not necessarily monotonic decline in net income or profit decline of 80% or more in a single year	At least three years of sustained income growth
Hambrick and Schecter (1983)	Average pre-tax ROI for two years of declining real profit before taxes	An average two-year pre-tax ROI greater than 20%
Slatter (1984)	At least three successive years of declining real profit before taxes	Real profits before taxes increased in four out of the following six years
Robbins and Pearce (1992)	Two successive years of increasing ROI and ROS followed by an absolute, simultaneous declines in ROI and ROS for a minimum of two years at a rate greater than their industry averages	Two successive years of absolute, simultaneous increases in ROI and ROS at a rate greater than the industry average, and a return to pre-downturn levels of ROI and ROS

Barker and Duhaime (1997)	At least three consecutive years of ROIC below the risk-free rate of return and an Altman's Z-score of less than 3.00 for at least 1 year during downturn.	At least three years of ROIC above the risk-free rate of return, continuing to and including the latest fiscal year.
Bruton et al. (2003)	Declining ROI over three consecutive years and lower than the risk-free rate of return during downturn.	Positive difference between average risk-free adjusted ROI in declining years and average three-year period adjusted ROI following decline.
Morrow et al. (2004)	At least three years of declining ROI preceded by two years of successive increases in firm performance.	Increase in industry-adjusted ROI after decline.
Chen and Hambrick (2012)	ROE greater than COE for at least two consecutive years, immediately followed by a year of operating losses (before extraordinary items).	Three consecutive years or increasing ROE and increasing market-to-book ratio.
Ndofor et al. (2013)	Two consecutive years of declining ROA after a base year with ROA greater than 5% and a net loss in the second year of decline.	Two years of increasing ROA after the two declining years and achieved and maintained positive ROA by at least the sixth year after the base year.
Collet et al. (2014)	Bankrupt firms within the Finnish Restructuring of Enterprises Act	Firms that reorganized within the bankruptcy procedure
Tangpong et al. (2015)	At least three consecutive years of ROI below the risk-free rate of return and industry-average ROI, and a Z-score below 3 for at least one year.	Three consecutive years of ROI above the risk-free rate and industry average ROI.

Source: Own elaboration based on Pearce and Robbins (1993).

Nevertheless, as Boyne and Meier (2009: 846) point out, definitions of decline and turnaround are subject to interpretation by external stakeholders, so "whether organizations are performing weakly or strongly should be based not on the judgements of researchers but on the perceptions of key stakeholders in an industry (e.g. suppliers, customers, rivals and regulators)". This stands particularly true for bankrupt firms, since main stakeholders (legislators, creditors and practitioners) measure the performance of the bankrupt firm by the result of the proceeding (survival or liquidation), and also by profitability indicators (increasing or decreasing performance).

In conclusion, the turnaround situation involves the need for strong management action on the verge of firm survival threat and its success or failure is measured in terms of a variety of indicators that provide consensus on the declining situation and it must be operationalized according to stakeholders' expectations.

1.3.2. The causes and severity of decline and effectiveness of turnaround.

Seminal turnaround studies assessed that turnaround strategies should be aligned with the causes of decline (Bibeault, 1982; Hofer, 1980; Schendel et al., 1976). Initially, the causes of decline have been classified between strategic or operating (Schendel et al., 1976). Table 1.8 reflects the causes and responses classification proposed by Schendel et al. (1976), in which the strategic/operating distinction is done. Strategic causes of decline, such as decreased profit margins, would require measures as vertical integration, diversification, divestments or TMT changes. On the other hand, operating causes as depressed price levels or recessions would necessitate of major plant expenditures or improved efficiency ratios. Additionally, Richardson et al. (1994) defined the existence of decline based on the strategic misalignment in a changing environment situation, which mainly led to business failure because of lack of leadership or mismanagement of firm's declining performance.

Table 1.8. Schendel et al. (1976) causes of decline-turnaround responses

Causes	Responses
Strategic	
Decreased profit margins	Vertical integration
Increased wages	Diversification
Increased competition	Divestment
Raw material supply	Top Management changes
Management difficulties	
Operating	
Depressed price levels	Major plant expenditures
Recessions	Functional areas emphasis
Strikes and labor problems	Improved efficiency ratios
Excess plant capacity	

Source: Schendel et al. (1976).

The majority of authors, however, divide the causes of decline between external and internal, as proposed by Cameron et al. (1988). External causes of decline have been linked traditionally to changes in industry or general environment factors. Such changes include environmental jolts, technological changes, industry deterioration and competitive pressure (Trahms et al., 2013), all of them not directly influenced by the firm's management (Schweizer and Nienhaus, 2017). Academics have found that distress is more likely to happen during industrial decline (Carter and Van Auken, 2006; Pearce and Robbins, 1993) given the vicious circle produce by credit restriction and demand reduction (Benmelech and Bergman, 2011; Campello et al., 2011).

On the other hand, internal causes have been regarded as those on which the firm's managers have direct influence. Particularly, prior scholars have identified operating and inefficiency problems (Hofer, 1980), high leverage (Routledge and Gadenne, 2000) or maladaptation to the firm's industry (Cameron et al. 1988). While the last one may seem an external cause, Arogyaswamy et al. (1995) argue that the source is external, but the inherent causes that produce decline are internal, given that the firm did not take the measures needed for such adaptation and, what was once a strong strategic position may no longer be preferred by the new market configuration. Purves et al. (2016) explored non-financial factors associated with decline, and found that management skill, experience and involvement in the firm's strategy as well as the Board composition had a direct impact in failure.

Collet et al. (2014) summarized the thirteen causes found in the literature, identified in 10 studies of turnaround, as depicted in Table 1.9. Internal causes include mismanagement (poor management, poor financial management, poor marketing management, poor human resource management), over indebtedness (high gearing, high short-term indebtedness, significant bad debt) and significant one-off causes (big failed project, problems with one major contract). External causes are those related to the firm's immediate and wider business environment (declining demand, increased competition, adverse macroeconomic conditions). "Sheer bad luck" is recognized as internal or external cause of decline.

Table 1.9. Causes of decline.

Internal	External	Internal or external
Poor management	Decline in demand	Sheer bad luck
Poor financial management	Increased competition	
Poor marketing management	Adverse macroeconomic conditions	
Poor human resource management		
High gearing		
High short-term indebtedness		
Significant bad debt		
One big project that failed		
Problems with one major contract		

Source: Collet et al. (2014: 127).

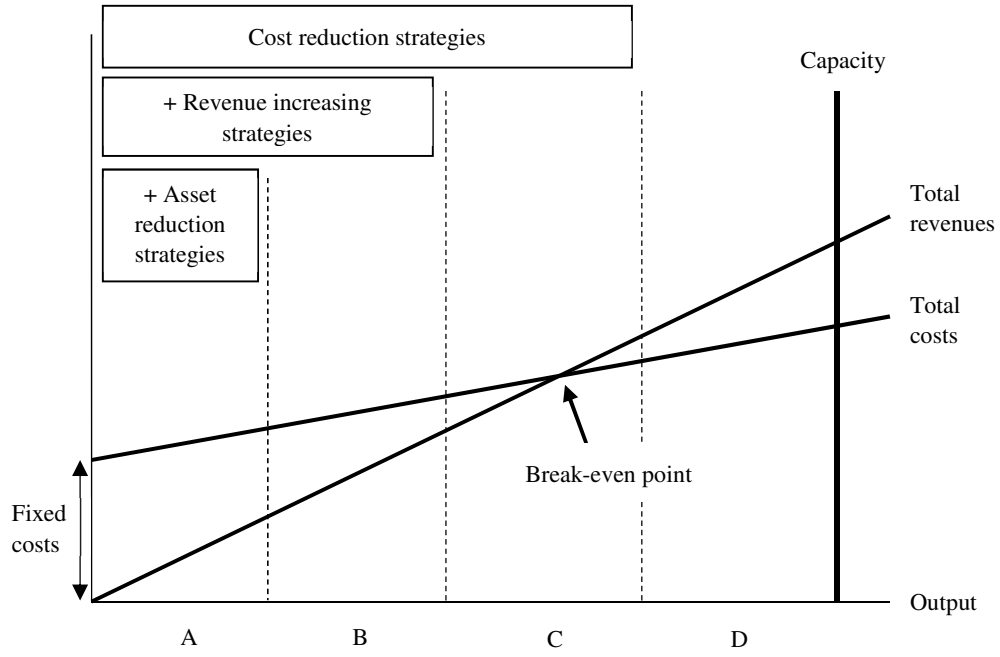
As Winn (1993) argues, each cause of decline must be faced with appropriate turnaround measures. Specifically, internal causes of decline require efficiency-oriented responses, while performance problems attributable to external causes needed the adoption of entrepreneurial measures. Most empirical studies have corroborated that efficiency-related responses were successful in turnaround whose primary cause was internal, and entrepreneurial actions proved to be effective in situations in which external causes of decline predominated (Francis and Desai, 2005; Hambrick and Schecter, 1983; Hofer, 1980; Meyer, 1982; Robbins and Pearce, 1992; Schmitt and Raisch, 2013).

The success of a turnaround is also contingent on the severity of decline. Severity can be defined as the degree to which the firm has declined (Schweizer and Nienhaus, 2017). Pearce and Robbins (1993) considered that severity could range from low (declining sales or margins) to high levels (imminent bankruptcy). In any case, severity of decline shapes the firm's response given that it determines slack resources available to take strategic actions (Morrow et al., 2007) or the time that the firm has to react (Tangpong et al., 2015). In higher severity situations, action must be decided and resources are scarce (Schmitt and Raisch, 2013), thus the turnaround response is extremely limited by those constraints.

Hofer (1980) considered the severity of decline as a contextual factor determining the effectiveness of turnaround actions, either operating or strategic. The relationship between appropriate operating turnaround actions and the firm's operating conditions are represented through a break-even diagram, as

shown in Figure 1.9. Firms that operate in corridors A, B or C, this is, under the break-even point, must adopt operating measures in order to get to corridor D. Cost reductions are adequate in the three corridors A, B or C. If the firm operates in corridor A or B, revenue increasing strategies will be required in addition to cost reductions. If the crisis is so severe that the firm operates under its fixed costs level (corridor A), asset reductions are necessary in addition to revenue increasing and cost reduction actions.

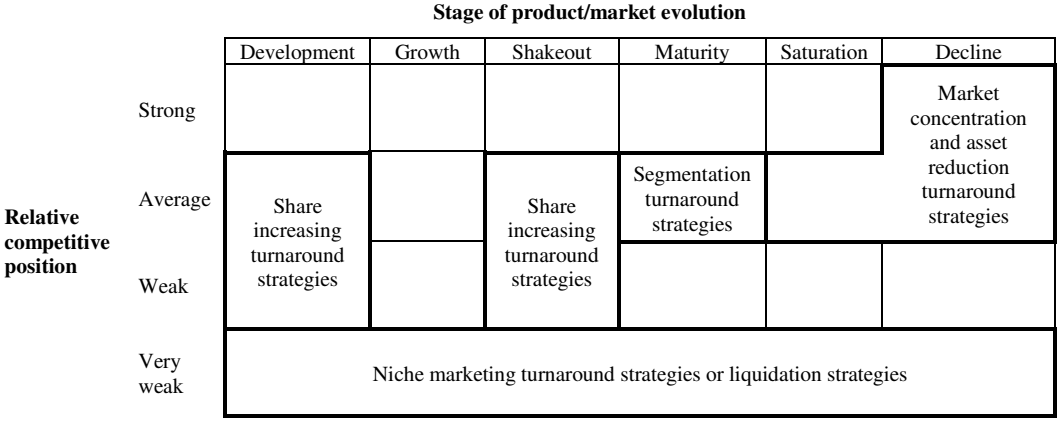
Figure 1.9. Operating turnaround decision model.



Source: Hofer (1980) and Pandit (2000).

Regarding external causes of decline, Hofer (1980) suggested to assess the strategic position of the firm by comparing its relative competitive position and stage of product or market evolution (see Figure 1.10). In case that a firm has an average or weak competitive position and its product is in a development stage, share increasing turnaround strategies are advised. The same strategy is proposed when the firm has similar competitive position (average or weak) but the product/market is in a shakeout situation. When the product/market are declining but the firm is in a strong competitive position, market concentration and asset reduction strategies are appropriate. Finally, if the firm's competitive position is very weak, niche marketing or liquidation strategies are suggested.

Figure 1.10. Strategic turnaround strategies decision model.



Source: Hofer (1980).

Slatter and Lovett (1999) linked generic turnaround strategies according to the cause of decline, as shown in Table 1.10. Despite the authors did not provide empirical validation of this classification, they assured that these were the more common and often successful turnaround strategies adopted by declining firm's managers. Hence if the main cause of decline was poor management, the recommended turnaround strategies should be new management or organizational change and decentralization. In case that the firm suffers inadequate financial control, also new management, improved financial control and decentralization are advised. The subsequent causes (except for lack of marketing effort), high cost structure, competitive weakness, big projects or acquisitions and financial policy are to be corrected mainly through retrenchment efforts (cost or asset reductions and refocusing), or recovery measures (growth via acquisition). Although no corroboration is provided, the classification helps in understanding the linkage between causes of decline and turnaround strategies on which other authors built their propositions.

Table 1.10. Causes of decline and generic turnaround strategies.

Cause of decline	Principal generic turnaround strategies required
Poor management	o New management o Organizational change and decentralization
Inadequate financial control	o New management o Improved financial control o Decentralization
High cost structure	o Cost reduction o Product-market refocusing
Lack of marketing effort	o Improved marketing
Competitive weakness	o Product-market refocusing o Cost reduction o Improved marketing o Asset reduction o Growth via acquisition
Big projects or acquisitions	o Asset reduction
Financial policy	o Asset reduction o New financial strategy

Source: Slatter and Lovett (1999).

In empirical studies, Robbins and Pearce (1992) found that cost reductions strategies were necessary in every turnaround, regardless of the cause of decline or severity. However, in high severity situations it was required that the firm took asset retrenchment measures, as Hofer (1980) proposed. Schmitt and Raisch (2013) also found that the severity of decline influenced in the ability of the firm to undertake retrenchment and recovery measures combinedly. Firms suffering higher severity crises were not positively associated to such combination given their lack of time and resources.

In conclusion, both causes and severity of decline shape the effectiveness of turnaround strategies. External causes require entrepreneurial actions, while internal are to be solved by efficiency moves. On the other side, the higher the severity of decline, the stronger the focus on retrenchment strategies should be.

1.3.3. The effectiveness of retrenchment.

While the empirical findings show a more consistent and positive effect of strategic actions on turnaround outcomes, the effect of retrenchment actions has been equivocal or even contradictory (Barker and Duhaime, 1997; Trahms et al., 2013). Despite being an established strategy, its effectiveness has not proved as universal as Robbins and Pearce (1992) suggested. This is the reason why retrenchment deserves a particular section within this research.

Retrenchment is both a *stage* and a *strategy* within the turnaround process. The seminal paper on retrenchment to achieve turnaround is Robbins and Pearce (1992). Retrenchment is defined as the "initial response to turnaround situations. For many firms consists of reductions in costs and assets. The primary objective for these reductions is to stabilize performance decline" (Robbins and Pearce, 1992: 291). Dewitt (1998) defines retrenchment as a downsizing approach that keeps the firm's scope while preserving or even increasing production.

Building on the retrenchment-recovery model, a key assertion in the turnaround literature is that when survival is threatened, it is *necessary* to undertake retrenchment measures that stabilise the performance decline and provide a base for recovery and growth. Robbins and Pearce's (1992) sample consisted of firms in the textile industry that, following prosperity - defined as two consecutive years of increasing return on investment (ROI) and return on sales (ROS) - experienced a minimum of two years decline in ROI and ROS relative to industry average. Successful turnarounds were defined as those firms that subsequently resumed prosperity and achieved increasing, above industry average ROI and ROS for two consecutive years.

Two types of retrenchment were defined: *cost* retrenchment (net reduction in total costs) and *asset* retrenchment (net reduction in total assets). They found that both cost and asset retrenchment were positively correlated with turnaround performance. Furthermore, the correlation was strongest for firms facing more severe turnaround situations. They concluded that "*retrenchment was a critical strategic element in attaining turnaround"* (Robbins and Pearce, 1992:303). The same authors later reasserted that retrenchment must be aggressive and far-

reaching, not piecemeal, incremental and narrow and that retrenchment may be sufficient with nothing further required to turnaround (Pearce and Robbins 2008). In this sense, several empirical studies have confirmed the effectiveness of retrenchment for the turnaround success (Barbero et al., 2017; Bruton et al., 2003; Chowdhury and Lang, 1996; Schmitt and Raisch, 2013).

However, other contradictory results have been produced (Schweizer and Nienhaus 2017). Lim et al. (2013: 42) state: "… retrenchment is one of the most widely used strategies; nevertheless, it is a poorly understood and understudied topic … Empirical research supporting the efficacy of the retrenchment strategies has been limited or equivocal; and little is known about when, how, and in what form retrenchment should be used.". Barker and Mone (1994) suggest that retrenchment may be a consequence of decline rather than a means for turnaround. Sudarsanam and Lai (2001) found that non-recovery firms engaged primarily in "fire-fighting" strategies, such as costs or assets reductions. Others found that whilst cost and asset retrenchment may be appropriate within a mature industry like textiles, these actions are argued to be inappropriate in other contexts. Other authors who have contradicted or introduced nuances to the universal validity of retrenchment have investigated different industries and environments, the strategic focus of the firm, the implementation and timing.

Morrow et al. (2004) question the universality of retrenchment in high growth and innovative environments and find that asset or cost reduction did not improve profitability in these environments to the same extent as in mature or declining industries. Cost retrenchment was found to have a positive effect on firm performance in mature and declining industries, while asset retrenchment was negatively related with performance increase in declining industries, but positively associated in growing and mature industries. Thus, the competitive environment decisively shapes turnaround strategies (Porter, 1985; Porter, 1991).

Also, certain cost and asset retrenchment actions are argued to be more effective than others depending on the rent-creation mechanism of the firm, as found by Lim et al. (2013). The authors used a sample of declining Japanese firms to conclude that firm-based and industry conditions determine the

effectiveness of retrenchment actions. Cost-cutting measures proved to be detrimental in firms with a higher Schumpeterian rent focus, while asset retrenchment eroded performance in firms with a higher Ricardian rent focus.

Additionally, implementation of retrenchment strategies in recently acquired firms was negatively associated with performance increase (Castrogiovanni and Bruton 2000), and timing has demonstrated critical for the effectiveness of retrenchment, arguably because early-retrenchers were found to have higher probabilities of survival than procrastinators (Tangpong et al., 2015).

Two main reasons have been proposed to explain the contradictory results. In first place, samples have been overly heterogeneous. Particularly, sampled firms attempting turnaround have not begun at the same starting point. Solvent and insolvent firms have been mixed within broad definitions of decline that include profitable firms underperforming industry average and unprofitable firms in threat of liquidation (Pandit 2000; Schweizer and Nienhaus 2017). Similarly, broad definitions of what constitutes a turnaround have mixed firms that aim to survive with others aiming to achieve sustainable competitive advantage and so above industry average performance. Secondly, some relevant variables, such as the competitive environment, were conceptually considered in prior turnaround studies (Lim et al., 2013; Ndofor et al., 2013) but their effects on high severity situations were overlooked. A summary of the described views of the effectiveness of retrenchment is depicted in Table 1.11:

Table 1.11. Retrenchment results in the literature

Authors	Sample	Impact of retrenchment	Results
Robbins and Pearce (1992)	32 US textile firms	Positive	Retrenchment is key for turnaround success. Cost retrenchment is necessary in every turnaround, while asset retrenchment is required when the severity of the crisis is high.
Barker and Mone (1994)	32 US textile firms	Negative	Retrenchment is the consequence of decline, and not a strategic measure to reverse it. Retrenchers have higher performance improvements because of their poorer financial condition.

Chowdhury and Lang (1996)	153 US firms	Positive	Retrenchment is the most widely used strategy within SMEs. Increase of employees' productivity is the best predictor of successful turnaround. Also, reduction of fixed assets and stretching accounts payable positively influence the turnaround outcome.
Castrogiovanni and Bruton (2000)	46 US distressed and acquired firms	None	Retrenchment shows no effect in post-acquisition performance of distressed firms attempting turnarounds.
Sudarsanam and Lai (2001)	166 potentially bankrupt firms	Excessive retrenchment is negative	Firms that retrenched too much were more likely to fail in the turnaround process. Their strategic focus was fire-fighting rather than growth-oriented strategies.
Bruton et al. (2003)	90 Overseas Chinese firms	Positive	Retrenchment on fixed assets and focusing the business (reducing sales) had positive effects on the turnaround. Changing the Chairman of the Board had no significant effects.
Morrow et al. (2004)	417 US firms	Contingent on the industry	In growth industries, asset retrenchment had a positive relationship with turnaround, while cost retrenchment had none. In declining industries, cost retrenchment had a positive effect, while asset retrenchment negatively impact performance.
Boyne and Meier (2009)	140 Texas school districts	Negative	Cost retrenchment reduces the turnaround probability
Schmitt and Raisch (2013)	107 Central European firms	Positive	Retrenchment strategies had a positive effect in the turnaround process. When the causes were mainly external, retrenchment had no significant effect. Retrenchment could be combined with recovery except when a severe crisis affected the firm.
Lim et al. (2013)	367 Japanese firms	Contingent on the rent-creation mechanism	Retrenchment effectiveness is moderated by the rent-creation mechanism of the firm. While cost retrenchment is more detrimental for Schumpeterian focused firms, asset retrenchment improved Ricardian focused firms performance.
Tangpong et al. (2015)	96 US firms	Positive if adopted early	Early rather than late retrenchment increases the probability to achieve a successful turnaround. Particularly, early asset retrenchment (divestments) and early geographic exists proved to positively impact the turnaround outcome. No effect was found for layoffs.

Source: Own elaboration.

In summary, retrenchment is a well-established but not universal cure for every turnaround. Several conditions shape the effectiveness of retrenchment strategies, and few of those factors have been assessed by prior studies. Thus, a potential for future research lays in this area of BT.

1.3.4. The content of turnaround strategies.

What a declining firm should do when attempting a turnaround is another key factor that academicians have addressed in the research field. The traditional division of retrenchment and recovery actions has closed the door to more granular approaches to the content of turnaround. Concrete actions are particularly useful for managers, who very often find themselves with generic solutions that do not provide particular cures for their struggles. These actions have also been classified within the retrenchment-recovery partition.

On the side of retrenchment, the main areas that have deserved deeper insights by scholars are tangible assets, working capital (inventories and receivables), costs of goods sold (COGS), selling general and administrative costs (SG&A), labor cost and interest expenses (Hambrick and Schecter, 1983; Lim et al., 2013; Morrow et al., 2004; Robbins and Pearce, 1992; Schmitt and Raisch, 2013; Slatter and Lovett, 1999).

Slatter and Lovett (1999) proposed a set of generic turnaround strategies classified in a 7-point "ingredients" scale for a successful recovery (Table 1.12). The first ingredient, crisis stabilization, requires taking control of the crisis, cash management, asset reduction, short-term financing and first-step cost reduction. Secondly, the area of leadership often requires a change of CEO and/or a change of other senior managers. Thirdly, to enhance stakeholders' support, adequate communications are necessary. Fourth, the focus on strategy deals with redefining the core business, divestments and further asset reductions, refocusing of product and/or market, downsizing, outsourcing and investment measures. Fifth, an organizational change may be required, for which structural changes, key people (such as managers) changes, improvement of communications, building commitment and capabilities and new terms and conditions of employment are needed. Sixth, an improvement in critical

processes may be essential, dealing with sales and marketing, further cost reductions, quality standards, responsiveness and information and control systems. Seventh, and finally, a financial restructuring may require refinancing debts and/or further asset reductions.

Table 1.12. Generic turnaround strategies.

Ingredients for a successful turnaround	Generic turnaround strategies
1. Crisis stabilization	• Taking control • Cash management • Asset reduction • Short-term financing • First-step cost reduction
2. Leadership	• Change of CEO • Change of other senior management
3. Stakeholder support	• Communications
4. Strategy focus	• Redefine core business • Divestment and asset reduction • Product-market refocusing • Downsizing • Outsourcing • Investment
5. Organizational change	• Structural changes • Key people changes • Improved communications • Building commitment and capabilities • New terms and conditions of employment
6. Critical process improvement	• Improved sales and marketing • Cost reduction • Quality improvements • Improved responsiveness • Improved information and control systems
7. Financial restructuring	• Refinancing • Asset reduction

Source: Slatter and Lovett (1999).

Since the focus of this research is essentially put on turnaround strategies for bankrupt firms, the crisis stabilization ingredient is the one that deserves a particular attention:

- Reduction of debtors. This strategy consists on dealing with overdue payments or reducing the terms of receivable accounts. It is one of the fastest measures if well implemented, and could include the following activities:
    - Offering early settlement discounts on reliable debts (usually expensive money)
    - Contracting a factoring or invoice discount arrangement with a financer (also expensive money).
    - Renegotiate trading terms towards a reduced credit period.
    - Focusing production and sales towards better-paying customers.
    - Persuade customers to pay in advance of order delivery.
- Extension of creditors. This area, while a quick source of cash, must be handled with caution because of the reaction that it could produce on suppliers. Many of them, alarmed by the situation, could withdraw any commercial credit and make the working capital management even tighter.
- Reduction of stocks. While improving inventories management is one of the biggest areas of opportunity for turnaround, in the stabilization stage the focus must be put on selling obsolete and slow-moving stock. Realizing such stock will produce an unexpected cash raising that will also serve for the purpose of immediate survival.
- Stopping or reducing planned expenditure. Usually, in a severe crisis capital expenditure will be reduced to the minimum or even completely halted. Also, discretionary expenditure (advertising, trade exhibitions or training) normally will be go on hold, in order to obtain immediate savings.
- Short-term financial support. In case that the aforementioned sources do not work, managers will need to ask for external help approaching stakeholders. Normally, the declining firms tend to extend the existing bank credit facilities or call for additional equity infusion. However, in this stage, the firm is in a weak bargaining position, and any additional financing, since extremely necessary, will also be at a heavy cost.

1.3.5. The role of stakeholders.

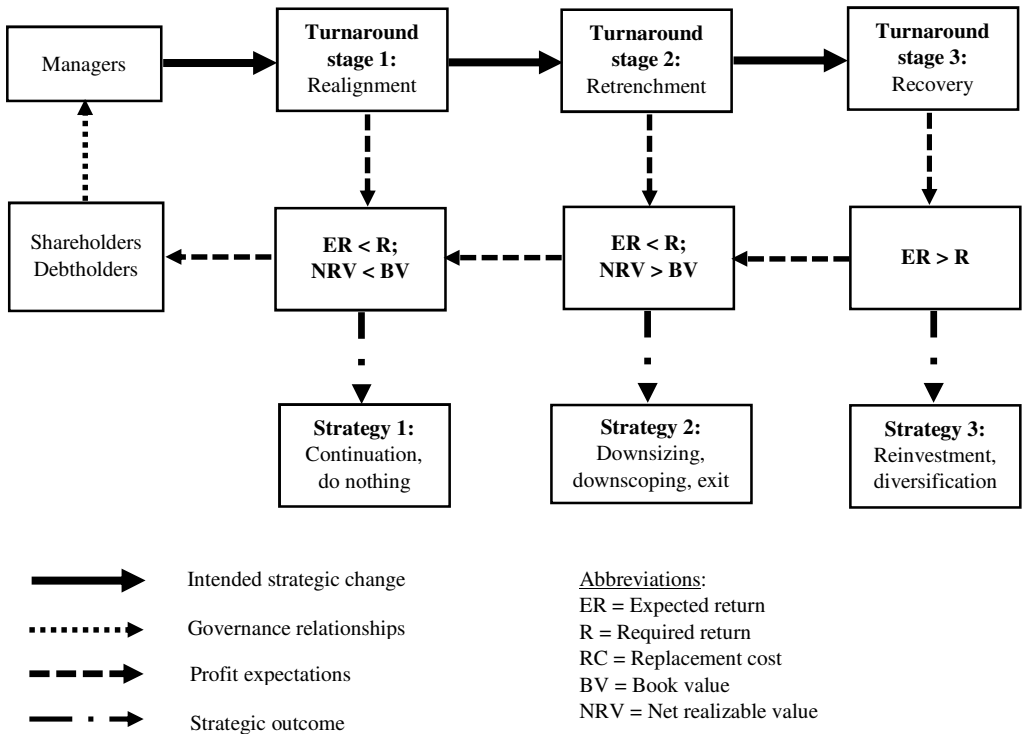
Despite the focus of the turnaround process has been generally put on the content of the turnaround, stakeholders have been gaining increasing attention by turnaround scholars in recent years (Filatotchev and Toms, 2006; Nixon et al., 2004; Pajunen, 2006; Trahms et al., 2013; Xia et al., 2016). Stakeholders become critical players for the firm's future, particularly during decline, since the firm's survival depends mainly on their attitudes and power (Donaldson and Preston, 1995). When the firm's performance sinks, stakeholders normally withdraw their support (D'Aveni, 1989a) which can lead to its complete failure (Weitzel and Jonsson, 1989). However, their role during the process is much more complex, since the support withdrawal is not linear and immediate, and several actions can be taken to manage the relationships with stakeholders.

Pajunen (2006) proposes that during decline stakeholders influence is based in both direct resource dependence and structured-based forms of power. Also, there are significant shifts in their weight in the turnaround process. For instance, while employees could be minor or potential stakeholders in the ordinary course of business, in a decline and turnaround they normally become a governing one, since their involvement and commitment with the firm is critical for the turnaround success. Similarly, hedge funds which are not the usual financers of the firm and thus do not play a relevant initial role, often take the banks' position in distressed firms with the aim of turning them around or selling them, thus becoming governing players in the process (Altman and Hotchkiss, 2006; Pajunen, 2006). In the last case, the bank would shift from governing player to minor one.

Filatotchev and Toms (2006) extended the two-stage turnaround model to incorporate governance aspects (Figure 1.11). The authors suggested the existence of the "realignment" stage prior to retrenchment and recovery. Such stage must be completed before commencing the subsequent ones. For the realignment stage to be passed, it is required that certain threshold is trespassed in relation to the severity of the crisis and its consequences on the firm's assets valuation. If the firm is not in such a severe situation that stakeholders are not forced to intervene in order to reverse decline, the firm's managers will be

prevented from carrying out turnarounds because of these governance constraints. As a result, two main conclusions are drawn from their study: (1) Realignment is a precondition for successful retrenchment and (2) the realignment stage requires such a severe situation affects the firm that stakeholders reevaluate their expectations and motivate decisive actions by managers.

Figure 1.11. Filatotchev and Toms (2006) turnaround model.



Source: Filatotchev and Toms (2006).

The effects that governance constraints have on retrenchment are the following (Filatotchev and Toms, 2006):

- Cost retrenchment will be facilitated where the cost base of the firm is variable rather than fixed.
- In case that the cost base is mostly fixed, cost reductions will be more difficult without altering the firm's strategy.
- Asset retrenchment will rely on the ability to generate cash flow from disposals. Asset specificity, liquidity in second hand market and

similar barriers exist in some industries, and thus asset retrenchment cannot be uniformly taken.

Finally, from the bankruptcy perspective, Xia et al. (2016) studied how bankrupt firms evolved after emerging the procedure, and support of particular stakeholders was found critical for a successful outcome. Firms that could obtain positive attention from stakeholders also gained positive interpretations of their efforts during bankruptcy, and thus increased the likelihood of complete reorganization.

1.3.6. The path-dependent pattern of decline and turnaround.

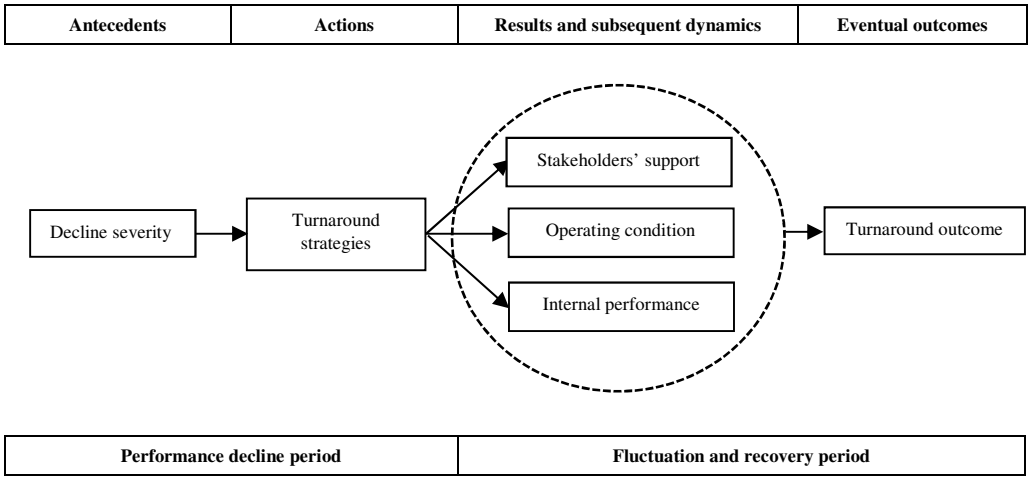
Recent turnaround authors have built their propositions on the grounds of the path-dependent pattern of decline and the turnaround process (Tangpong et al., 2015; Barbero et al., 2017). Path dependence yields a set of dynamic processes in which some events or action can unintendedly unfold a self-reinforcing circle that carry lasting consequences that subsequent actions can only change to a limited extent due to the mainly irreparable and inseparable nature of such processes (Garud et al., 2010; Tangpong et al., 2015).

That process aggravates the downward spiral of decline if no action is taken, or if it is faulty measures are adopted. Taking into account the path-dependent course is critical to understand the turnaround process and its dynamic nature. As a consequence, prior studies have found that "when" turnaround action is determinant for the outcome of the process.

As suggested by Tangpong et al. (2015), the path-dependent pattern of the turnaround process follows four stages, as depicted in Figure 1.11: (1) antecedents, (2) actions, (3) results and dynamics flowing from actions, and (4) outcomes. This turnaround model comprehensively integrates the nature of the process suggested by prior scholars (situation-responses-outcome) with the dynamics that affect the turnaround development, which may be uncontrollable for the firm's managers. The antecedent of the process is the severity of decline, directly influenced by the causes of distress (Arogyaswamy et al., 1995). The response to such decline is the adoption of turnaround strategies, which aim at

stabilizing (retrenchment) and restore (recovery) prior performance. However, the implementation of such measures will have consequences on stakeholders' support, operating conditions and internal performance. The turnaround outcome lays on the influence that the chosen actions produce on these three aspects, and the subsequent dynamics of the process. The key point is that if the firm does not takes decidedly action, the downward spiral will further sink performance and will make even more difficult to reverse decline (Tangpong et al., 2015).

Figure 1.12. The path-dependent pattern of business turnaround.



Source: Adapted from Tangpong et al. (2015).

A proper timing, speed and rhythm have proved to be critical for predicting a successful turnaround (Barbero et al., 2017; Tangpong et al., 2015) attending to the path-dependent pattern of the process. Tangpong et al., 2015 found that procrastination was a bad strategy when attempting turnaround, and that early retrenchment actions provided a higher probability of success than later ones. Particularly, early divestments and geographic exits proved beneficial for turnaround outcome, while late divestments and geographic exited were found detrimental. The third measured studied by the authors (layoffs) had no significant effects on the outcome. Barbero et al. (2017) added the contingency of environment in their study. They suggest that early retrenchment has a positive impact on performance when the environment is munificent, while in dynamic contexts has the contrary effect. Additionally, fast cutting actions are positive only in dynamic contexts. An irregular rhythm of retrenchment has a positive effect on firm performing in both munificent and dynamic environments.

In summary, a turnaround also follows a path-dependence pattern that may be influenced by managers through the adoption of turnaround strategies. The path-dependence pattern implies that, if no action is taken, the downward trend of the firm will worsen through time, and the end of such path will be the firm's disappearance. Therefore, turnaround measures are necessary to enhance stakeholders' support, the firm's operating condition and its internal performance in order to generate the conditions to reach a successful outcome. If no proper action is engaged, the pattern will push performance downward unstoppably, which will make even tougher to reverse decline.

1.4. Conclusions.

BT is the framework under which the decisions that managers make when facing organizational decline are studied, which embraces the *situation*, *responses* and *outcomes* of the *process*. A literature review was conducted on the relevant turnaround research from 1992 to 2017 and added some prior seminal studies that constitute the grounds of the field still nowadays. What it was found is not far different from extant reviews. The retrospective outlook showed that, despite the extended and general use of turnaround strategies, scholars have failed to build their findings on solid theoretical grounds. Several disputes arise from existent studies, the first of which is the turnaround definition itself. Secondly, it is assumed that retrenchment is the first stage, a common necessary response to decline. However, its effectiveness has been put in doubt in several studies which tested its timing, different environments, conditions or it has been simply regarded as a natural consequence of decline. Thirdly, what remain clears and it has been outlined by most recent turnaround studies is that decidedly action is needed should the firm aim to succeed. Recent streams in BT point out that the usual trend of a declining firm is to keep declining unless stabilizing (retrenchment) and restoring (recovery) measures are adopted. That remains the core of BT, firms must act in order to reverse a survival-threatening decline and restore or improve prior performance.

Accordingly, research efforts should be directed towards the following issues in the future. In first place, scholars need to further investigate the grounds on which the research field lays and provide solid theoretical foundations for future studies to build one. A starting point could be the use of homogeneous samples in terms of turnaround definition and to find consensus on the definition of a turnaround. Second, while recovery measures are regarded to have a positive impact on the firm's performance after decline, stronger consensus is required in retrenchment. Despite that it is an extended and easy to adopt strategy, its effectiveness has not been wholly corroborated. Here again homogeneous sampling and turnaround definition could help to shape the process, content and implementation of retrenchment. Its lasting consequences for the firm's performance, as well as the variety of contingencies that affect it (severity of

decline, causes of decline) should be borne in mind when studying it in the future. Finally, further analyses on the path-dependence pattern of turnaround should be engaged. The pattern is extremely helpful when explaining the importance of timing in a turnaround. However, future studies could address the deepness of the adopted strategies, the different areas in which they are adopted, the timing of each of them and their combination. For instance, a typical turnaround manager could have the doubt of what reducing first, assets or costs. And how it would affect each other? Will it have the same impact to sell assets than reducing half the costs? What is the role of the competitive environment when taking retrenchment or recovery actions? These and more questions need to be analyzed by turnaround scholars in the studies to come.

This review is not exempt of limitations. The main drawback is linked to the review scope. A large quantity of turnaround and related studies have been produced by academics, and thus examining each of them through content analysis may make an interminable task. Consequently, some important contributions from other studies may have not been considered. Nonetheless, studies published in top management journals have the highest impact and make the overall and most precise description of the BT situation of this research line, including its main contributions and extant limitations.

Chapter 2. The effectiveness of turnaround strategies in bankrupt firms

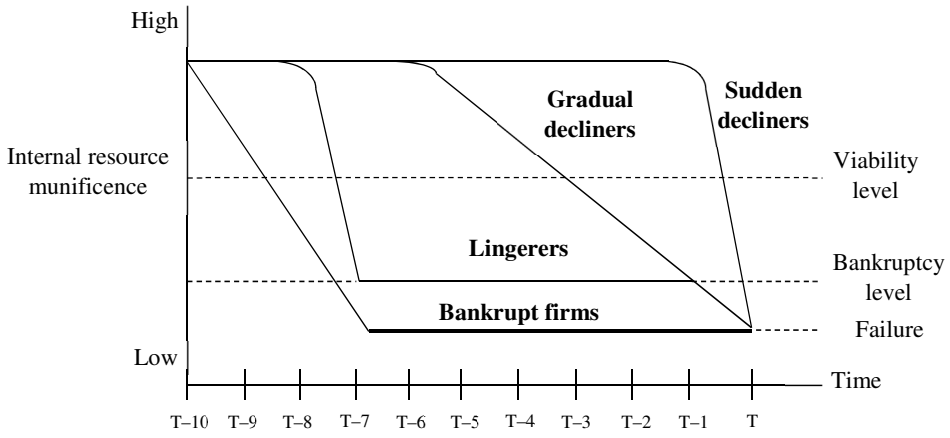
Introduction.

Substantial interest has been directed towards turnaround strategies during the Great Recession. Also, the growing bankruptcies' figures have brought the attention of academics with the aim of studying which factors could make firms survive such critical situation. However, despite this apparent link between turnaround and bankruptcy, only one study has investigated the adoption of turnaround strategies by bankrupt firms (Collet et al., 2014). This neglect can be explained by the traditional consideration of bankruptcy as the "organizational death" (Sheppard and Chowdhury, 2005; Sheppard, 1994), the one from which the firm cannot be recovered. Nonetheless, the modernization of bankruptcy regimes around the world towards debtor-friendly approaches signal a change of paradigm. Experience has shown that a bankrupt firm can be turned around in spite of the high financial and reputational costs of the procedure (James, 2015; Moulton and Thomas, 1993; Van Hemmen, 2009). However, what should managers do in order to success in their turnaround attempts within the bankruptcy procedure? In this research, retrenchment and recovery responses are addressed in a situation of extreme severity. Are retrenchment strategies effective within the bankruptcy context? Do retrenchment strategies offer the same results in different competitive environments? Do recovery strategies contribute to survival and turnaround during bankruptcy? These uncovered questions deserve further attention in the light of the recent trend in the field.

Considering such questions, the hypotheses have been built on the grounds of bankruptcy and turnaround. These are overlapping concepts. Almost all bankrupt firms have suffered a decline in their performance that has lead them to bankruptcy (D'Aveni, 1989a; Weitzel and Jonsson, 1989), while a turnaround occurs when the survival of the firm is in peril after a decline in results and performance (Trahms et al., 2013). The difference between both terms, however, is that not all firms attempting turnaround necessarily become bankrupt (Barker and Duhaime, 1997). Thus, bankrupt firms face a turnaround situation, but not all turnarounds imply being bankrupt.

The grounds for linking bankruptcy and turnaround were set by D'Aveni (1989a). Figure 2.1 depicts a set of declining patterns proposed by the author, who suggested that declining firms followed three types of trajectories before bankruptcy: sudden decline, gradual decline and linger. However, in the purpose of this research, the model has been redefined in order to introduce bankrupt firms, which also suffer decline (either sudden or gradual) but fall below the *bankruptcy level*. This level was the steepest point for D'Aveni (1989a). Nevertheless, according to the position of this research, bankrupt firms can also be included in the patterns of decline, and the end of their trajectory, as well as for the rest of decliners, is *failure*, a point from which the firm cannot be recovered.

Figure 2.1. D'Aveni's (1989a) patterns of decline preceding failure.



Source: Adapted from D'Aveni (1989a).

The explicit inclusion of bankruptcy in the turnaround context was suggested by Trahms et al. (2013), who proposed to capture the nuances of the turnaround process, by classifying the firms in increasing order of success, from the worst possible result (liquidation), to survival, and recovery or even sharp-bend recovery. Also, Cook et al. (2011: 290) recognized that their study on the British Company Voluntary Arrangement (CVA) system covered the "under-researched question of the turnaround of bankrupt SMEs". Therefore, the recent literature has advocated the inclusion of the two possible bankruptcy outcomes (liquidation/survival) in the turnaround scope to shelter all the cases in which a firm viability is put on doubt. The approach taken by Collet et al. (2014) assumes that a bankrupt firm within the Finnish restructuring regime can be turned around

by means of turnaround strategies. Finally, James (2015) studied several circumstances that affected bankrupt firms in the US that increased or decreased their probability of success. Nevertheless, no conceptual link is made between bankruptcy and turnaround, a gap that is aimed to fill within this research.

In the purpose to investigate the effectiveness of retrenchment and recovery responses and the influence of competitive environment for bankrupt firms, the literature on bankruptcy and turnaround is reviewed in this chapter. It is also aimed to link previous findings on turnaround strategies with the concerns that arise to firms within a bankruptcy procedure.

The main strategic decisions in BT are determined by the stage of the process, the severity of the situation and the causes of decline (Robbins and Pearce, 1992). The first response in a turnaround situation is retrenchment, the one in which the firm stabilizes decline, restores positive cash flows and establishes the base for future growth. However, research of the effectiveness of retrenchment is far from settled, and there are no few studies that challenge the conventional assertion that retrenchment is *necessary* whatever the severity of decline or the cause of turnaround. Is this statement also true for bankrupt firms?

Bankruptcy also conveys significant limitations for the firm's managers, given that the legal regime imposes the appointment of an external professional (bankruptcy administrator) who supervises and validates managerial decisions. Besides, some relevant measures, such as terminating contracts or selling relevant assets require Court approval. Thus, how the limitations that bankruptcy poses on firm's managers affect the effectiveness of retrenchment strategies? Also, the bankruptcy regime establishes the *freezing* of "old debt" payments, thus it allows for an air infusion to the bankrupt firm, which can reorganize without a burden over its shoulders, at least temporarily. This period, known as "automatic stay", must be used by the firm to restore cash generation and become economically strong, which will make the stakeholders, and particularly creditors, believe in its viability. Is the automatic stay period used in that purpose? Does it constitute enough time to undertake all the restoring measures that the firm needs?

Directed by these questions, the aforementioned literature has been reviewed. Three hypotheses are formulated within this chapter in the light of the analysis of past findings and evidences. The focus is put on the determinants of BT success, and particularly the effectiveness of retrenchment and recovery strategies in the context of bankruptcy, as well as the moderating role of the competitive environment, which several prior studies have found to significantly influence the outcome of the turnaround process (Morrow et al., 2004; Ndofor et al., 2013).

2.1. Bankruptcy in business turnaround literature.

Traditionally, bankruptcy has been regarded as an *outcome* of the turnaround process, synonymous of *failure* (D'Aveni, 1989a; Sheppard, 1994). This idea comes from the previous conception of the bankruptcy procedure as a means to orderly liquidate firms and not saving them from disappearance (Franks and Sussman, 2005). Consequently, little interest has bankruptcy generated among turnaround scholars, who mostly have believed that bankrupt firms cannot be turned around.

However, recent experience and regulatory trends have shown that it is worth saving bankrupt firms, at least those economically viable, given the socio-economic interests involved as well as the pernicious effects that liquidation has on the firm's stakeholders (Carter and Van Auken, 2006; Flynn and Farid, 1991; Moulton and Thomas, 1993; Trahms et al., 2013).

As far as it is known, the first and only study that addressed the issue of turnaround within a bankruptcy context was Collet et al. (2014). The authors analyzed the main causes and responses of Finnish bankrupt SMEs as a means to shed light on the unequal results of turnaround strategies and the effectiveness of the Finnish restructuring framework in providing survival opportunities. Additionally, the study data came mainly from bankruptcy administrators. In contrast with the Spanish regime, the study was conducted in one of the most effective legal frameworks, in which almost 50% of firms achieve survival.

Collet et al. (2014) integrated bankruptcy and turnaround on the basis of the contingency framework proposed by Hofer (1980), which implies that the BT responses depend on the causes of decline. The main conclusions of the study were:

- Successful turnarounds (survival): The most important source of decline were one-off causes, while management change, cash generation, cost-cutting and retrenchment were the most relevant responses.

- Failed turnarounds (liquidation): The critical causes of decline were poor management and adverse economic environment.

The authors did not question the suitability of the bankruptcy framework for BT given the orientation of the Finnish Restructuring Act, primarily focused on providing survival to distressed firms.

Similar studies have been also conducted from the strategic literature, addressing the British CVA system (Cook et al., 2000; Cook et al., 2001; Cook et al., 2011; Pandit et al., 2000). CVA is aimed at financial troubled firms, particularly SMEs, and it is intended to resolve their difficulties without being forced into liquidation. The investigations of Cook and colleagues proved consistent with the extant literature on SME success and failure and proposed several policies to enhance this bankruptcy regime to promote survival among distressed firms. Thorburn (2000) provided some insights into the small firms' bankruptcy procedure from Sweden, which proved much more efficient in terms of costs and debt recovery rate than US Chapter 11. Also the study of the WorldCom bankruptcy case (Pandey and Verma, 2005) was carried out from a strategic point of view. However, no conceptual link was done between bankruptcy and turnaround, despite it is implicitly assumed that bankrupt firms could be turned around.

2.1.1. The renewed orientation of bankruptcy procedures.

This research is aligned with the most recent regulatory trends at both European and Spanish level. Starting in 2000, the European Council adopted the Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (EC, 2000), in which a first attempt to harmonize all European insolvency regimes. However, the regulation entered into force during a long growing period for the EU economy, so it remained virtually unapplied. In this same context the Spanish bankruptcy law was born (2004), but its inefficiency was not revealed until the economic crisis arrived. An additional EC effort through the European Parliament Resolution on insolvency procedures (EC, 2011) did not resulted in significant results, at least in the Spanish context, except from an extensive review of the law, that nonetheless did not increase the

survival rate for firms entering the procedures (García-Posada and Vegas, 2016). From the literature perspective, Bris et al. (2006) found that liquidation processes (such as Chapter 7 in the US) were significantly more expensive than reorganization ones, which serves as a starting point to renew the bankruptcy procedures perspective.

After the global economic crisis, and the subsequent adjustment period, in which the Spanish private sector (companies and individuals) maintained high levels of leverage, the IMF (2014) advocated for a decided policy of debt reduction as a mean to restructure corporates financing. As the Fund (IMF, 2014:14) stated "In-court restructuring options are too limited, and processes are too expensive and slow. Public creditors (tax agency, social security) have little flexibility for out-of-court debt restructuring and are not brought to the negotiating table with other creditors, which is particularly problematic for SMEs". The persistence of these problems, all of them derived from the extant law, led to a new reform agenda, which took advantage of the Commission Staff Working Document on Impact Assessment on a New Approach to Business Failure and Insolvency (EC, 2014). As a result, the Spanish insolvency law was reformed six times during 2014 and 2015, and the expected results are an increase of the proceeding's speed as well as its costs' reduction (García-Posada and Vegas, 2016). Once again, the improvement of survival rates has remained in the background, despite the intention of regulators to provide effective survival and rehabilitation mechanisms (Madrid-Guijarro et al., 2011).

The two last European attempts aim at solving three main problems: (1) the harmonization of the European insolvency regimes, (2) the prevention of insolvency, (3) the early resolution of insolvency and distress (either by liquidation, winding up or reorganization) as a mean to preserve the firm assets' value and, finally, (4) the rehabilitation of *bona fide* debtors. These two initiatives are the Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (EC, 2015) and the Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase

the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU (EC, 2016).

The strong impact of the crisis on job losses as well as firms' disappearance motivated the building of the current regulatory framework. The Commission Staff working document (EC, 2014) addresses the most suitable measures to increase the survival and rehabilitation rates in insolvency proceedings, and concludes that (EC, 2014:8) "the highest recovery rates for creditors [as well as survival rates] are recorded in economies where restructuring is the most common insolvency proceeding", as opposed to alternative stricter and more formal procedures, which make them more expensive and slower. In this sense, the Company Voluntary Arrangement (CVA) in the UK is a highly recommended framework for the rest of EU members to apply, according to its high recovery and survival rates (Cook et al., 2011). One of the main characteristics of the CVA regime is the low involvement of the court as well as the debtor remaining in control of the business, under the supervision of a bankruptcy practitioner.

As a conclusion, it can be easily understood that also the regulatory trends point to an evolution to a legal framework in which survival will be favored with stronger mechanisms for the bankrupt firms to adopt them.

2.1.2. Attempting a turnaround from a position of bankruptcy.

The intention to file for bankruptcy protection has been largely discussed in the literature. While some authors contend that bankrupt firms have the willing to liquidate and sell assets in an orderly manner with few or none intervention of main stakeholders (Baird and Rasmussen, 2003; Flynn and Farid, 1991), others suggest that bankruptcy is still a tool for firm survival and reorganization (Kahl, 2002; LoPucki, 2003; McCormack et al., 2016). Arguments to stand for the first position mainly arise from some assertions and common knowledge that, however, has little empirical validation. Conversely, the institutional controls and law protection that a bankruptcy procedure offers makes it a mean to preserve the going concern value of the firm. That is the main objective in the majority of bankruptcy regimes in developed countries and, as such, legislators

and practitioners must be provided with the best recipes to preserve that value in the benefit of direct and indirect stakeholders (LoPucki, 2003).

The first issue that arises when facing decline is in which stage of the process is the firm and the degree of severity of the crisis that is suffering. Bankruptcy involves a condition in which the firm cannot pay its debts back (Gilson, 2010), so severity of decline is assumed to be high. Despite some declining situations could be sudden and take managers by surprise, usually bankrupt firms have been suffering a decline that firm's managers have not been able to reverse and finally leads to bankruptcy (Bruton et al., 1994; D'Aveni, 1989a). Such decline, as for non-bankrupt firms, erodes its resource base, reduces stakeholders' support and deteriorates internal climate (Arogyaswamy et al., 1995; Pajunen, 2006; Tangpong et al., 2015). Additionally, if no action is adopted, decline advances unstoppable and further reinforces the downward-spiral leading the firm towards liquidation.

In such situation, bankrupt firms are expected to adopt primarily retrenchment strategies. Several reasons support this assertion. In first place, retrenchment is advised for every turnaround, regardless of the severity of decline (Robbins and Pearce, 1992). The higher the severity of decline, the strongest the need for retrenchment actions, starting by reducing costs followed by selling assets (Pandit, 2000). As Hofer (1980: 24) asserted: "Check your current operating health before assessing strategy health. The latter is irrelevant if the company goes bankrupt in the near term". Thus, the first objective in a bankruptcy is to "stop the bleeding" and stabilizing decline. For instance, Collet et al. (2014) confirmed that cost-cutting and other retrenchment strategies played a critical role in successful turnaround for bankrupt firms.

In second place, in severely distressed firms the combination of retrenchment and recovery strategies has been found as ineffective (Schmitt and Raisch, 2013), so only cutting and downsizing measures are expected to be effective in the context of bankruptcy. Being that certain, this research also evaluated if recovery strategies taken after the retrenchment stage were effective in providing higher probabilities of success. This is due to the positive impact

that strategic actions have shown in abundant turnaround literature (Barker and Duhaime, 1997; Morrow et al., 2007; Ndofor et al., 2013).

Nonetheless, some arguments may be presented against the effectiveness of recovery strategies during bankruptcy. For instance, financing new investments during bankruptcy has been a rare event, given the lack of confidence that banks have on bankrupt firms (Naujoks, 2012). Additionally, bankrupt firms' managers are believed to be focused on keeping the business running, obtaining the needed cash to maintain the firm alive and increasing the efficiency of operations, thus they can devote fewer time to change the firm's strategic position.

However, if a bankrupt firm is able to raise enough funds to undertake relevant investments it is a clear signal of stakeholders' support to the future recovery of the firm. Moreover, recovery strategies are not limited to acquiring new resources, but other creative measures can reposition the firm and provide an increase in sales. As Morrow et al. (2007) found, recombining existing resources can produce beneficial effects on performance turnarounds at a relatively low cost for the firm, something that might be useful in high severity situations like for bankrupt firms.

2.2. Determinants of a successful turnaround.

This research rationale follows the main stream of turnaround research, the retrenchment-recovery process (Robbins and Pearce, 1992), while incorporating some understudied determinants that need to be accounted for in successful turnarounds. Based on the turnaround contingency framework (Hofer, 1980), prior scholars have argued that the effectiveness of turnaround actions were contingent upon the severity of the crisis (Arogyaswamy et al., 1995; Hofer, 1980; Robbins and Pearce, 1992). If severity of decline is high, as it occurs in a situation of bankruptcy, stakeholders have the incentive to push managers to adopt retrenchment measures should be more effective in a performance turnaround (Robbins and Pearce, 1992, Schmitt and Raisch, 2013). Furthermore, the higher the severity, the stronger the intensity of cutting actions should be (Hofer, 1980; Pandit, 2000; Pearce and Robbins, 2008). However, retrenchment strategies are not universally valid, as literature has proven (Barker and Duhaime, 1997; Barker and Mone, 1994). One of the main factors to account for a successful retrenchment is the competitive environment (Morrow et al., 2004; Ndofor et al., 2013). In prior studies, retrenchment has proved unsuccessful for declining firms in munificent industries, while it was partially valid for declining firms in declining industries.

On the other hand, recovery strategies can be implemented only after having adopted retrenchment measures. The reason is that retrenchment provides the needed slack resources for future repositioning of the firm (Robbins and Pearce, 1992). Accordingly, once cuts have been adopted, can the firm start its recovery. Strategic measures have generally presented a positive association with turnaround in substantial studies (Barker and Duhaime, 1997; Ndofor et al., 2013). However, a situation of extreme severity may pose relevant limitations to firm's action, and relatively few alternatives exist for bankrupt firms to adopt recovery measures. In contrast, bankrupt firms that are able to implement sales-increasing or investing strategies are expected to significantly improve their chances to turn around.

2.3. Retrenchment responses.

The first response to decline and bankruptcy should be retrenchment (Bibeault, 1982; Hofer, 1980; Robbins and Pearce, 1992). Firms that find themselves in a situation of resource scarcity during decline, as in bankruptcy, must adopt stabilization measures that generate immediate cash flow and financial slack (Burgeois, 1981), needed to adopt further recovery measures and restore prior performance. As pointed out by literature, retrenchment works (Boyne and Meier, 2009) while depending on a set of variables such as timing (Tangpong et al., 2015), content (Lim et al., 2013), severity, suddenness (Francis and Pett, 2004) or environment (Morrow et al., 2004). Also, as found by Boyle and Desai (1991), primarily causes of small firm decline are internal, hence efficiency-oriented strategies are the proper ones to reverse it.

Bankrupt firms are expected to adopt mainly retrenchment strategies for varied reasons. In first place, in situations of high severity a combination of retrenchment and recovery strategies proved to be inefficient, while only retrenchment strategies provided significant turnaround success (Schmitt and Raisch, 2013). Secondly, bankrupt firms are *de facto* controlled by external stakeholders, mainly creditors, that will not allow the firm's managers to spend money before assuring that critical efficiency measures have been implemented (Van Hemmen, 2009). Thus, the first hypothesis is formulated as follows.

Hypothesis 1: In a bankruptcy procedure, retrenchment strategies impact the probability of turnaround success.

The impact of retrenchment will depend on the strategy content, since unequal retrenchment strategies will have different effectiveness (Barker and Mone, 1994). That is why the response-related hypotheses have been divided into cost and asset retrenchment. Following Morrow et al. (2004), Lim et al. (2013) and Ndofor et al., (2013) these are the main areas on which managers act when attempting a turnaround in its first stage. Also, similarly to Chowdhury and Lang (1996), the vast majority of firms attempting turnaround from bankruptcy are SMEs, so their strategic range is reduced to such actions.

2.3.1. Cost retrenchment.

Cost efficiency measures are one of the most extended and widely adopted by almost all firms attempting turnaround (Hambrick and Schecter, 1983; Hofer, 1980; Robbins and Pearce, 1992; Chowdhury and Lang, 1994). The aim of cost-cutting actions is to improve cash flow generation as well as stabilize the firm's operations (Sudarsanam and Lai, 2001). For Spanish bankrupt firms it is relatively easier to adopt cost reduction strategies, since the bankruptcy regime allows to terminate contracts in the interest of all the creditors (Van Hemmen, 2009). The usual costs upon which belt-tightening measures are applied are Research and Development (R&D), Selling, General and Administration (SGA), Cost of Goods Sold (COGS) and interests expenses (Hambrick and Schecter, 1983; Chowdhury and Lang, 1996; Lim et al., 2013; Tangpong et al., 2015).

Robbins and Pearce (1992) contend that cost retrenchment is necessary in every turnaround attempt if the firm aim to success. In fact, the authors sustain that the higher the level of retrenchment, the higher the success degree of the turnaround. Cost efficiencies are quick measures and require little or no capital outlay (Hofer, 1980; Robbins and Pearce, 1992).

This general assertion has been challenged by subsequent turnaround scholars, that have introduced nuances regarding the source of decline and the context in which the firm develops its business. Barker and Mone (1994) considered that retrenchment was a consequence of decline, and not a strategic move. The authors believed that cost retrenchment did not provide substantial turnaround potential. Boyne and Meier (2009) even found that an excessive focus on cost retrenchment in public firms exacerbated decline. Besides, Lim et al. (2013) found that reducing costs was detrimental for firms with a stronger Schumpeterian rent-creation mechanism.

Nonetheless, Hofer (1980) proposed that cost-cutting measures should be adopted when the firm is surrounding its breakeven point, suggesting the adoption of "moderately large short-term decreases in costs" (Hofer, 1980: 26). The studies which employed firms in severe crisis a suffering substantial economic and financial difficulties (Bibeault, 1982; Cameron, 1994; Hambrick and Schecter, 1983; Grinyer et al., 1990; Pearce and Robbins, 2008; Robbins

and Pearce, 1992; Tangpong et al., 2015) revealed that cost-cutting strategies proved beneficial for the turnaround outcome. Therefore, an intense cost retrenchment in severely distressed firms (like bankrupt ones) seems to have a positive effect in their survival and subsequent performance. Thus, the following hypothesis is proposed:

Hypothesis 1a: In a bankruptcy procedure, the extent to which a firm adopts cost retrenchment strategies increases its probability of success.

2.3.2. Asset retrenchment.

Divestments in declining situations are typically done to generate cash needed to repay debts or keep the business operating, to focus on core business or to get rid of unprofitable assets (Morrow et al., 2007; Robbins and Pearce, 1992). As such, it may be a substitute of new debt or equity issues, which might be difficult to obtain during bankruptcy.

Regarding the Spanish environment, Garcia-Posada and Mora-Sanguinetti (2012) found that the preference of banks to secure loans against tangible assets has resulted in a higher rate of investment in tangible assets among Spanish firms than in similar countries (Rico and Puig, 2015). In such a situation, tangible assets may not be critical and so easily off-loaded and so it is expected a positive relationship between tangible asset retrenchment and survival. Supporting this reasoning, Aguiar-Diaz and Ruiz-Mallorquí (2013), who studied the link between overcoming a bankruptcy and the composition of creditors, found that firm survival was more likely when liabilities were concentrated in the hands of banks.

Accordingly, creditors secured with a mortgage will not support reorganization unless a superior alternative is proposed, one that is likely to result in the original terms of the mortgage being observed (Franks and Sussman, 2005). When this is the case, it is likely that the firm implements deep asset retrenchment. Bruton et al. (2003) find a positive relationship between the magnitude of asset retrenchment actions and firms survival. Similarly, Denis and Rodgers (2007) suggested that firms are more likely to survive if they implement severe asset and liability cuts during retrenchment. However, Lamont et al.

(1994) found that firms that implement gradual and more limited retrenchment recover faster. Supporting this, Winn (1997) and Sudarsanam and Lai (2001) find that firms that fail to recover restructure more intensively but also more ineffectively than firms that successfully turn around.

Hofer (1980) also proposes that firms whose sales are well under the breakeven point (their fixed costs are higher than sales) should reduce their fixed assets. However, the level of assets that is advisable to reduce is normally contingent on the time and resources that firms have to respond to decline. A firm that reduces its assets in excess can put a burden to future competitiveness and productive capacity (Wild and Lockett, 2016). Hofer (1980:27) limits the asset sales strategies to "the level needed to meet the firm's cash flow needs for the next three or six months". Additionally, resource-based view authors (Barney, 1991; Penrose, 1959; Wernerfelt, 1984) acknowledge that firm's tangible (and intangible) assets constitute one of its most relevant resources, thus over-depleting them will presumably despoil of the source of its competitive advantage. To address this controversy, it was hypothesised:

Hypothesis 1b: In a bankruptcy procedure, the extent to which a firm implements asset retrenchment strategies decreases its probability of success.

2.4. Recovery responses.

Recovery is the subsequent response in a turnaround situation (Lohrke et al., 2004). As shown by Schmitt and Raisch (2013) recovery-focused actions should be taken after retrenchment measures in severely distressed firms. The combination of both will produce detrimental results, since recovery actions require substantial efforts and financial resources, which a firm in a severe crisis might not have access to. Nonetheless, building on first turnaround scholars (Hofer, 1980; Schendel and Patton, 1976; Schendel et al., 1976) Barker and Duhaime (1997) found that strategic actions were essential in every turnaround attempt, particularly when causes of decline were associated with poor strategic positioning. Thus, failure to enact successful turnarounds is often explained by the inability to enact strategic changes. Subsequent scholars have reinforced the perception that recovery actions should be present in a turnaround attempt, regardless of the firm's situation (Boyne and Meier, 2009; Ndofor et al., 2013) since it conveyed positive results in the final outcome. Thus, despite the limitations of the bankruptcy procedure, recovery measures have been tested given their high relevance in the literature. Hence, the second hypothesis is formulated as follows.

Hypothesis 2: In a bankruptcy procedure, recovery strategies impact the probability of turnaround success.

Attending to the limitations that a bankrupt firm suffers, only two recovery strategies were assessed, sales growth and investments (Arogyaswamy et al., 1995; Barker and Duhaime, 1997; Ndofor et al. 2013). Some other recovery actions were found in the literature, such as new product introduction or strategic alliances (Ndofor et al., 2013), contact external stakeholders (Boyne and Meier, 2009) or self-renewal (Ruiz-Navarro, 1998; Stopford and Badden-Fuller, 1990).

However, this research focused in the two aforementioned strategies for two reasons. In first place, studies dealing with recovery strategies are mostly focused on large firms, which can develop more complex actions and also there is some periodical public reporting about them. This is not the case of SMEs, the majority of firms of the sample used (Chowdhury and Lang, 1996), which do not

have the resources and capabilities that allow implementing such actions. In second place, due to the scarcity of resources that a firm counts with when facing bankruptcy, few repositioning strategies can be taken. Sales-increase strategies can be taken with extant labor force and a reconfiguration of the marketing effort (Schoenberg et al., 2013), while investment during bankruptcy can only be done when stakeholders give the necessary funds, considering that a part of the firm's value would be devoted to additional projects and not to their debts being repaid (López-Gutiérrez et al., 2015). Therefore, two strategies that can be easily handled by both SMEs and bankrupt firms were evaluated.

2.4.1. Sales growth.

Pursuing sales-growth actions seems to be a direct and natural mean to overcome bankruptcy, and it has been regarded as one of the main actions that declining firms should attain (Hofer, 1980). However, bankruptcy might not be the best context in which focus on increasing sales. During bankruptcy, firm's managers might be distracted by other, more urgent topics, such as retaining key employees and suppliers, obtaining new financing, keep the business running and preventing customers from turning their back on the firm (Naujoks, 2012, Trahms et al., 2013). Similarly, as found by Bruton et al. (2003) declining firms which tried to increase sales during a turnaround attempt had a negative outcome, suggesting that focusing was positively associated with turnaround. If a bankrupt firm operates with reduced or negative margins, a sales increase further damages its profitability, thus it should firstly correct its economic distress (Balgobin and Pandit, 2001).

Nonetheless, despite relevant arguments to consider that sales increase strategies will have detrimental effects on BT, the majority of scholars have considered that increasing sales was almost always a good strategy for turning around performance declines. However, such strategy must be adopted in a particular manner. Normally sales reductions derive from exiting non-profitable markets or decreasing demand during the retrenchment stage (Robbins and Pearce, 1992). However, bankrupt firms usually operate at their steepest point of decline (Hotchkiss, 1995). Therefore, when decline has been stabilized, and if

the product portfolio is still competitive and demand is adequate, sales increase was found to be a proper strategy (Hambrick and Schecter, 1983; Hofer, 1980). This confirms the findings of Schmitt and Raisch (2013) regarding firms suffering a high severity decline. Additionally, bankrupt firms have several means to increase sales, such as shifting resources to marketing or cutting prices to increase demand, which have few or no cost (Bruton et al., 2003). Accordingly, the following hypothesis is proposed.

Hypothesis 2a: In a bankruptcy procedure, the extent to which a firm pursues sales growth after adopting retrenchment strategies increases the probability of success.

2.4.2. Investments.

Investing during a turnaround situation is a rarely studied issue. During the retrenchment stage, investments are not prescribed as appropriate actions (Robbins and Pearce, 1992). When implementing retrenchment, firms must focus on cash generation through cost reductions and asset disposals, and only after having taken such actions is the firm able to invest in new assets (Hambrick and Schecter, 1983). Nonetheless, some forced-growth strategies proved to be detrimental for recovery (Moulton et al., 1996), which poses some doubts on aggressive investment strategies.

Prior scholars have generally supported that investments during the recovery stage can provide added value to the firm (Robbins and Pearce, 1992; Schendel et al., 1976; Slater and Lovett, 1999). Additionally, recessionary periods could present investment opportunities, given the assets prices drop (Mann and Byunn, 2017). Sudarsanam and Lai (2001) found that successful turnarounds were more determined by growth-oriented strategies rather than focusing on fire-fighting activities. Nonetheless, and similarly with what occurred with sales-increase strategies, it must be highlighted that their implementation during retrenchment is detrimental for performance turnaround (Schmitt and Raisch, 2013).

Investment activities also imply a substantial support from external agents, particularly in a resource-scarcity situation such as bankruptcy. Chakrabarti (2015) suggested that growth strategies during economic downturns were detrimental for performance, unless the firm engaged external institutions in such strategies. Similarly, bankrupt firms developing growing actions must count on the support of stakeholders, given that the required investments would be mainly done with funds provided by them, which at the same time are damaged parties of the bankruptcy. Thus, if a firm is able to achieve stakeholders support to increase investment, will also be a signal of success during the procedure. Consequently, the following hypothesis is proposed.

Hypothesis 2b: In a bankruptcy procedure, the extent to which a firm does investments after adopting retrenchment strategies increases the probability of success.

2.5. The role of competitive environment.

The contingency framework of BT suggests that the effectiveness of turnaround strategies is determined by the severity and causes of decline. While in this research bankruptcy constitutes an unequivocal measure of high severity crisis (D'Aveni, 1989a), the causes of decline are controlled by the inclusion of the competitive environment as a moderating variable (Robbins and Pearce, 1992).

Similarly to Ndofor et al. (2013), this research considered the competitive environment in which bankrupt firms developed their activity in order to account for factors that might impact the outcome of turnaround strategies, as proposed by the literature. It is undoubted that competitive environment shapes strategic responses (Porter, 1985; Porter, 1991) and turnaround scholars have taken into account the context under which strategic decisions were made. In this sense, Morrow et al. (2004) found that retrenchment strategies were moderated by the industry's cycle (growth, stagnation or decline). On the other hand, Ndofor et al. (2013) studied the effectiveness of both recovery and retrenchment actions for declining firms in a munificent industry, suggesting a negative association between retrenchment and strategic-oriented turnarounds. Therefore, the competitive environment matters when attempting a turnaround, thus the third hypothesis is formulated as follows.

Hypothesis 3: The competitive environment of a bankrupt firm moderates the effectiveness of the turnaround strategies adopted.

2.5.1. Retrenchment.

The competitive environment is expected to affect cost and asset retrenchment actions in different manners. On one hand, the economic environment seems to have no obvious influence on cost retrenchment. Morrow et al. (2004) found that cost-cutting actions were positively associated with performance turnaround in mature and declining industries, while it had no effect in growth industries. Except for publicly held firms (Boyne, 2004; Boyne and

Meier, 2009), no clear industry effects were found to impact the effectiveness of cost retrenchment.

Detrimental results were suggested by Guthrie and Datta (2008) in high R&D development, growth and low capital intensity, and by Lim et al. (2013) when considering the Schumpeterian focus of the rent-creation mechanism of the firm, which were also exacerbated when the firm operated in a Schumpeterian industry. However, Guthrie and Datta (2008) focused on employees downsizing as retrenchment measure, while Lim et al. (2013) captured the change of SGA as cost-cutting actions. Therefore, no homogeneous results can be drawn from their conclusions.

All in all, the retrenchment-recovery process argues that cost retrenchment is necessary whatever the cause and severity of decline (Robbins and Pearce, 1992). Lawton et al. (2011) further supported this assertion, suggesting that in firms suffering a severe decline cost retrenchment was positively associated with turnaround. Given that bankrupt firms suffer a high severity crisis, cost retrenchment is expected to be a universally prescribed strategy (Collet et al., 2014). Thus, it was not expected that competitive environment had any moderation effect on its impact on turnaround performance. Consequently, the following hypothesis was proposed.

Hypothesis 3a: In a bankruptcy procedure, the extent to which a firm adopts cost retrenchment strategies increases its probability of success, regardless of the competitive environment.

On the other hand, asset retrenchment measures present more nuances. Selling assets during a turnaround is problematic, given that the firm must face a dilemma. An asset disposal could generate enough cash for immediate survival (Filatotchev and Toms, 2006). However, being deprived from certain assets could pose a critical threat for long-term viability. Literature has found that competitive environment moderates such relationship. For instance, asset reductions were negatively associated with turnaround performance in declining industries, while it had a positive effect in mature or growing ones (Morrow et

al., 2004). The reason could be presumably that resale markets for assets is very limited in declining industries.

Conversely, asset retrenchment in growing or munificent industries was positively related to turnaround, probably because the more competitive asset resale market (Morrow et al., 2004). In contrast, Ndofor et al. (2013) found that asset reductions negatively impacted turnaround performance in software firms during the 1990s. However, the authors highlight that their analyses were done in firm-based declines (as opposed to industry-contraction-based ones). Therefore, the moderation effect of the competitive environment is confirmed in the sense found by Morrow et al. (2004). In summary, reducing assets in a declining industry is expected to have detrimental results for turnaround, while the opposed is anticipated to occur in munificent industries. As a result, the following hypothesis is formulated.

Hypothesis 3b: In a bankruptcy procedure, the extent to which a firm adopts asset retrenchment strategies increases (decreases) its probability of success in a munificent (declining) industry.

2.5.2. Recovery.

Recovery responses are also expected to be moderated by competitive environment to some extent. Firstly, sales-increasing strategies have been found to positively contribute turnaround after the retrenchment stage (Robbins and Pearce, 1992), since efforts during that stage are directed to refocusing and concentrating in the core business (Schoenberg et al. 2013). However, once concluded retrenchment, seeking sales growth has proved to improve the chances of successful turnarounds. Detrimental effects of sales-increasing strategies were only found in specific industries or contexts (Bruton et al., 2003), which difficultly can be generalized to others.

The recent study by Mann and Byunn (2017) found that firms pursuing market expansion or sales growth during recession had significant profitability increases. Capturing new customer trends as well as future growth opportunities, regardless of the competitive environment, will in every case promote the firm's

performance (Barker and Duhaime, 1997). In both environments, sales growth is a positive event. In declining industries, sales increase implies an expansion of market share despite a decreasing demand (Bruton et al., 2003), while increasing sales in a munificent industry should be a natural trend if the firm is relatively well positioned (Pearce and Robbins, 2008), and is will positively impact performance. Given that the competitive environment is not expected to substantially impact a sales-growth strategy, the following hypothesis is proposed.

Hypothesis 3c: In a bankruptcy procedure, the extent to which a firm adopts sales-increasing strategies after adopting retrenchment strategies increases its probability of success, regardless of the competitive environment.

Finally, the competitive environment casts relevant implications for investment opportunities. Robbins and Pearce (1992) argued that firms suffering from a poor strategic positioning should attempt strategic turnarounds. Firms operating in declining environments would probably have the need to improve their operations rather than investing further in a contracting market. Morrow et al. (2007) found that acquiring new resources during market-based crisis further eroded firms' performance. This might be due to a declining environment, which provides poor targets to invest. Consequently, investing in declining industries is expected to reduce the chances of a successful turnaround.

Conversely, Winn (1997) argues that asset expansion during productivity turnarounds contribute to add value and growth to the firm productivity and performance. It must be noted, however, that such acquisitions must be done in munificent industries. Investing in these industries have chances to be successful, given that the costs of not undertaking them are likely greater than the costs of doing them (Ndofor et al., 2013) given the need for strategic change. These findings were consistent with prior literature that argued that turnaround attempts from firm-based decline would benefit most from strategy changes (Arogyaswamy et al., 1995; Barker and Duhaime, 1997; Schendel et al., 1976).

In summary, while investment in contracting industries is expected to negatively impact the turnaround outcome, invest in munificent industries would

probably produce the contrary effect. To reflect that contradictory trends, the following hypothesis is suggested.

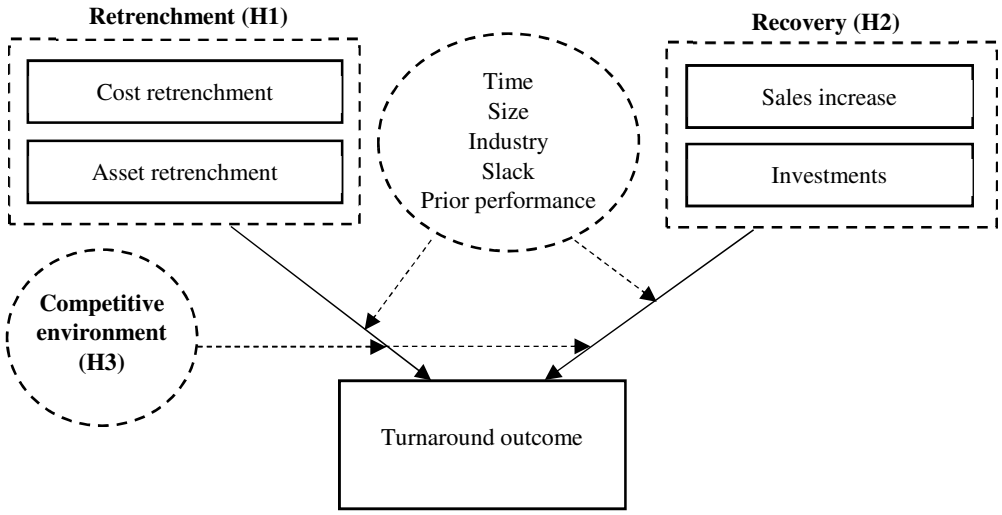
Hypothesis 3d: In a bankruptcy procedure, the extent to which a firm invests after adopting retrenchment strategies increases (decreases) its probability of success in a munificent (declining) environment.

2.6. Conclusions.

Building on the interrelationships of bankruptcy and BT, the potential impact of retrenchment and recovery strategies as well as the moderating role of competitive environment for bankrupt firms was hypothesized. Prior scholars' findings suggest that a bankrupt firm suffers a profound decline, and consequently, turnaround actions will be associated with the retrenchment stage, this is, focused on cost-cutting and selling assets. Also, recovery strategies were incorporated, given that some shelter for strategic actions was found based on prior literature. Particularly, pursuing sales growth and doing investments during bankruptcy were hypothesized as the proposed recovery actions. Finally, the moderating role of the competitive environment was accounted for, given the substantial impact that prior researchers have found between environment and effectiveness of turnaround strategies.

Therefore, three hypotheses are proposed according to the theoretical grounds exposed in this section. Particularly, these hypotheses consider the effects retrenchment responses, recovery measures and the moderation of competitive environment produce on the turnaround outcome. To validate the hypotheses two tests were proposed. In the first one (Test I) retrenchment and recovery measures are evaluated during bankruptcy, while in the second (Test II) the moderating role of the competitive environment is tested along with its impact on both retrenchment and recovery actions. These two tests were designed to capture the effectiveness of turnaround strategies and their intensity on the three defined outcomes during bankruptcy: liquidation, marginal survival or successful survival. An overview of the conceptual design of the present research is shown in Figure 2.2.

Figure 2.2. Research conceptual model.



Chapter 3. Research methodology

Introduction.

Previous contributions on the effectiveness of turnaround strategies and, particularly, retrenchment and recovery measures in situations of severe crisis, has led to conjecture their validity in the context of bankrupt firms. Bankruptcy has been neglected by prior scholars on the belief that bankrupt firms could not be turned around. However, the Great Recession has shown that many bankrupt firms, despite having suffered profound declines, have been able to stabilize their fall and even have recovered their prior profitability through the use of turnaround strategies.

Accordingly, the relationships deducted between turnaround strategies (retrenchment and recovery) their intensity and the competitive environment with the turnaround outcome (liquidation, marginal survival and successful survival) were tested, based on a sample of Spanish bankrupt firms. The empirical validation consists of two stages. Firstly, the effect retrenchment and recovery strategies was tested on three outcomes of the turnaround attempts in the bankruptcy procedure: liquidation, marginal survival and successful survival. Second, to test the expected moderating role of the competitive environment in the effectiveness of turnaround strategies, additional analyses were run. Predicting and control variables were introduced and ran in the analyses.

The use of a recent Spanish bankrupt firms' sample yields not only methodological interest, but also provides additional contributions to this research. In first place, as far as it is known, no prior studies have been carried out in the turnaround field using Spanish bankrupt firms. This inattention can be explained by two reasons. In first place, bankruptcy in Spain has been an object of study for exclusively Law and Finance scholars. Besides, prior turnaround scholars in Spain have studied cases of firms or specific industries which were suffering decline, but never fell into bankruptcy. In second place, similarly as in the rest of developed countries, bankrupt firms have been regarded as firms that, in the best scenario, the best way to saving them was to sold them out. However, there has been a shift of stream during the Great Recession, in which legislators and policymakers have acknowledged that saving existing firms is cheaper and worthier than abandoning them and creating new ones. In this context, the

Spanish government has reformed the bankruptcy law several times starting in 2011 and ending 2015, attempting to facilitate firms' salvation or, at least, their continuation as a going concern. The sample of 599 Spanish bankrupt firms allowed to study the actions they took in order to survive when attempting turnaround from a position of extreme crisis, which no prior studies, as far as it is known, have addressed before. Also, bankruptcy and turnaround were linked through the study of subsequent performance of bankrupt firms, given that the research's focus is not only to evaluate the probability of survival but also the study the development of the BT process. Finally, the sample is mainly comprised SMEs, representing more than 90% of firms in Spain and other developed countries, but generally understudied by turnaround scholars.

Therefore, analysis on such a particular sample is expected to contribute, not only to managers and practitioners, but also to policymakers and legislators, which are interested in knowing how bankrupt firms survive and provide them with the most suitable tools to achieve it.

In the present chapter, the research's methodology is described. First, the general background of turnaround and bankruptcies in Spain is presented. Second, data sources and extraction are described along with the identification of the final sample used in the empirical tests. Finally, measurements and statistical methods employed are exposed.

3.1. Turnaround studies in Spain.

Although the Spanish firms have suffered several crises since at least, 1978, BT studies employing Spanish firms have been scarce and mainly focused on specific industries or case-studies. While these studies, given their focus, may have produced interesting results, they are few and neither Spanish nor foreign academicians have seen an interest in widening the field. The origins of BT in Spain are placed in the book of Nueno (1992), a professor of IESE. His work deals mainly with short case-studies that show determined aspects of BT, such as recognizing the declining situation, corporate regeneration, facilitators, etc. The case-studies are principally from Spanish firms that dealt with decline or, even, bankruptcy, which increased the interest for this research. The approach of Nueno (1992) is eminently practical, and few theoretical grounds are followed or built in the book. However, the experiences shown reflect the majority of the aspects that a turnaround manager faces when attempting a BT.

The next BT study was the one of Ruiz-Navarro (1998), a case-study of a Spanish renowned shipyard's turnaround. Building on the theoretical grounds of strategic change and corporate rejuvenation, the author describes the process that the shipyard followed when its sales declined and should readapt to the new environment, derived from fewer demand of war ships. The firm used part of its resources and capacities to build new ones, that were extremely useful in the turnaround process that subsequently took. The new commercial application of its former military capacities was found to be the key for a successful turnaround.

The study of Pla-Barber et al. (2007) and the doctoral thesis of Toral-Pla (2010) addressed the analysis of BT in SMEs from the textile industry. Their focus was to analyze the impact that managers' perceptions had in the implementation of several turnaround strategies. The managers' background (education, perceptions, ownership) as well as some firm's aspects (age, access to resources, severity of decline) proved to decisively influence the adoption of retrenchment or recovery strategies

Finally, Zúñiga-Vicente and Vicente-Lorente (2006) studied the likelihood of organizational survival through strategic changes in the population of Spanish

banks during the period 1983-97. The authors integrated both significant environmental shifts and the adaptative reactions of the banks and tested whether the probability of survival increased or decreased when deep strategic moves were taken by the firms. The results favored the adaptative perspective versus the ecological perspective and, as a consequence, enhanced the theoretical grounds of BT. Surviving banks built their survival on those areas where they enjoyed solid competitive ability and were also interested in innovating or offering new products or services for their specific market niches. Thus, the process of identifying decline or turbulences, recognizing the need for strategic change, its implementation and success, as proposed by BT literature was also put forward in the research.

The rest of academic literature dealing with either declining or bankrupt Spanish firms comes mainly from the areas of Finance or Law. Bankrupt firms have been object of study mainly by institutions such as the Bank of Spain (García-Posada and Mora-Sanguinetti, 2012; García-Posada and Vegas, 2016; Van Hemmen, 2009) or the Public Commercial and Property Register (*Colegio de Registradores de la Propiedad y Mercantiles*) (Van Hemmen, 2016). Van Hemmen is the academician that took deeper insights into the bankrupt firms' population and its statistic characterization. Also an economic analysis of the bankruptcy law was done by Fernández (2004) when the regime was enacted. Subsequent scholars had varied interests in studying bankrupt firms, either in terms of liabilities' composition and its effect on survival (Aguiar-Díaz and Ruíz-Mallorquí, 2013) or comparing the Spanish bankruptcy system with others (López-Gutiérrez et al., 2012). However, this last research analyzed the former Spanish "suspension of payments law"[12]. Rico and Puig (2015) investigated the specific case of Spanish football clubs in bankruptcy, the industry with highest survival rate (91%) within the bankruptcy proceeding. The support of public administrations as well as the lack of financial debt proved key to their survival, despite critical problems of mismanagement or over-indebtedness (mainly derived from taxes and social security).

[12] *Ley de 26 de julio de 1922 de Suspensión de Pagos*, which remained in force until the bankruptcy lay (*Ley Concursal*) was enacted, in September 2004.

The recent study of Camacho-Miñano et al. (2015) assessed the characteristics that predicted the survival of Spanish bankrupt firms, and found that only five variables (industry, size, number of shareholdings, ROA and liquidity) could explain the bankruptcy outcome and predict the process for healthy firms as well. The authors followed a similar rationale than Altman (1969), Pozuelo et al. (2010) and Pozuelo et al. (2013) but employing more sophisticated statistical techniques. Finally, López-Gutiérrez et al. (2015) analyzed a set of German, Canadian, Spanish, French, Italian, British and American firms suffering financial distress, in order to corroborate the hypotheses of under or over-investment. The threat of bankruptcy was a factor that critically determined investment decisions for firms with few opportunities to invest.

In conclusion, BT is a quite rare issue for Spanish strategy academicians and few and isolated insights have been taken into the matter. Nonetheless, thanks to prior contributions, as well as the extensive analyses on some financial and legal aspects of Spanish bankrupt firms, this research can integrate both fields and contribute to the BT literature with an unexplored population for strategy scholars.

3.2. Organizational context. The Spanish bankruptcy procedure.

In Spain firm bankruptcies multiplied by nine from the beginning of the crisis (2007) until the year with the highest number of cases (2013) (INE, 2017). Nonetheless, the effectiveness of the Spanish Bankruptcy Law has been questionable (Creditreform, 2017), since only 7% of firms entering the proceeding survive and continue their businesses (Van Hemmen, 2016). This has resulted in a massive destruction of firms, employment, know-how and, in the end, potential resources and capabilities for future economic development. This situation calls for the study of how such minority of bankrupt firms achieve survival, in order to extend the measures adopted by them to the rest of bankrupt firms.

The bankruptcy procedure is the legal framework under which an insolvent firm files for protection in order to pay back its creditors' debts while, at the same time, attempts to survive. Bankruptcy regulation around the world is heterogeneous and there are numerous ways of exiting from it depending on traditions and culture. As Claessens and Klapper (2005) found, countries whose systems assured weaker creditors' rights and stronger judicial efficiency, were associated with greater bankruptcy usage and higher survival rates. Conversely, García-Posada and Mora-Sanguinetti (2012) concluded that the Spanish bankruptcy regime had a very low rate of usage and worse results than similar countries, thus suggesting that the Spanish case had some particularities that deserved a specific study. Those particularities, as well as the lack of research on the strategies undertook by Spanish distressed and insolvent firms, motivate the immersion in both areas.

A firm is defined as insolvent when it cannot meet its financial obligations to creditors, thus the definition meets the concept of *cash insolvency*, as opposed to *balance-sheet insolvency* (not enough assets to meet liabilities) stated by Gilson (2010). In the Spanish context, the bankruptcy procedure (Spain, 2004) – *concurso de acreedores* – provides two alternative solutions for the insolvent firms to pay their debts (Aguiar-Díaz and Ruíz-Mallorquí, 2013). On one hand, it is possible to achieve survival through an arrangement of payments with creditors, which may include delays and writing-offs of the outstanding debt.

Under this alternative (called *convenio*), debts are to be paid back through cash generated by the continuation of the business. If survival is not achieved, the firm goes into liquidation (*liquidación*), under which its assets will be sold in order to pay the creditors. This second alternative implies the firm's dissolution (Van Hemmen, 2009).

According to López-Gutiérrez et al. (2012), the Spanish bankruptcy regime has the following defining characteristics:

- It is required that the debtor is insolvent, this means, it cannot meet its financial obligations with its cash-flows. Distress is not regarded as a requisite for filing.
- Either the debtor or creditors can file for bankruptcy. In case that the filing is done by the debtor, the bankruptcy is voluntary, while if filed by creditors it is defined as compulsory. In the second case, the most usual consequence is the debtor's loss of management control.
- The firm management is generally hold by the debtor (except in compulsory filings), but it has limited decision-making capacity, since the intervention of a bankruptcy administrator (*administrador concursal*) appointed by the Court is required.
- The automatic stay, defined as payments freeze until a solution is achieved (Altman and Hotchkiss, 2006) is applied to unsecured creditors during the proceeding, and to secured creditor during one year since the declaration, or the start of the liquidation.
- The conclusion of the proceeding takes places when a reorganization plan is supported by the creditors, or the firm is liquidated. In the second case, the business can be sold as a going concern or, if there is no alternative, assets are liquidated individually.

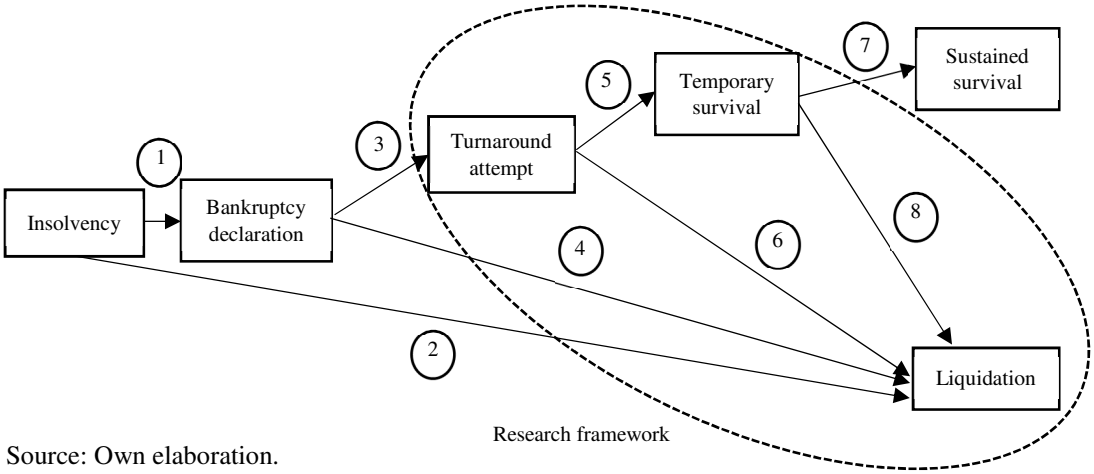
The Spanish bankruptcy regime can be defined as debtor-friendly (Fernández, 2004), since the bankrupt firm management keeps the control on the business in the majority of cases (only 8% of insolvencies are compulsory according to INE (2017)). However, the extremely high cost of the proceeding cause that it is filed only as a last resource alternative (Van Hemmen, 2009), which implies that the vast majority of firms enter in such a critical situation that

they cannot be restored. The regime's debtor orientation along with a low court efficiency produce a significant delay in the procedure's management that reduce both *ex ante* and *ex post* efficiency (Claessens and Klapper, 2005).

As a result, although survival is the preferential option in the law, it occurs very marginally, given that 93% of insolvent firms are liquidated and little or no return is provided to a large number of creditors (Van Hemmen, 2016). Starting in 2011, several reforms were undertaken on the bankruptcy law that, according to García-Posada and Vegas (2016) have improved the likelihood to achieve an arrangement and have reduced the duration of the proceeding, thus limiting the pernicious effects of being protected under this regime.

The overview of the procedure is depicted in Figure 3.1 In first place, a firm becomes insolvent. The firm (or one of its creditors) files for bankruptcy (1) or either goes directly into liquidation without filing for bankruptcy (2). If the firm has filed for the procedure, bankruptcy is declared and it may have two initial outcomes. On one hand, the firm may attempt to turn its situation around, being the purpose of the proceeding to achieve survival (3). However, the firm may reach the bankruptcy declaration in a situation of unviability, thus it may file for liquidation at the time of filing for bankruptcy (4). If the intention of the firm is to achieve survival, it may get support to a reorganization plan (5), which may allow for its temporary survival. In case that the plan is not supported by creditors, the firm goes into liquidation (6). Finally, only if the survival plan is accomplished and all committed payments are satisfied, the firm will achieve a sustained survival (7), while in the event that the plan is not fulfilled, the firm will be liquidated (8).

Figure 3.1. The Spanish bankruptcy procedure.



Source: Own elaboration.

Given that the focus of this research is put on the strategic measures that bankrupt firms adopt in order to survive and improve performance, the cases of firms attempting a turnaround (3), whose outcomes could be temporary survival (5) or liquidation (6) have been studied. Firms that enter liquidation before becoming bankrupt (2) and which enter liquidation at the same time they are declared bankrupt (4) were discarded, since no expectation of survival can be held for them.

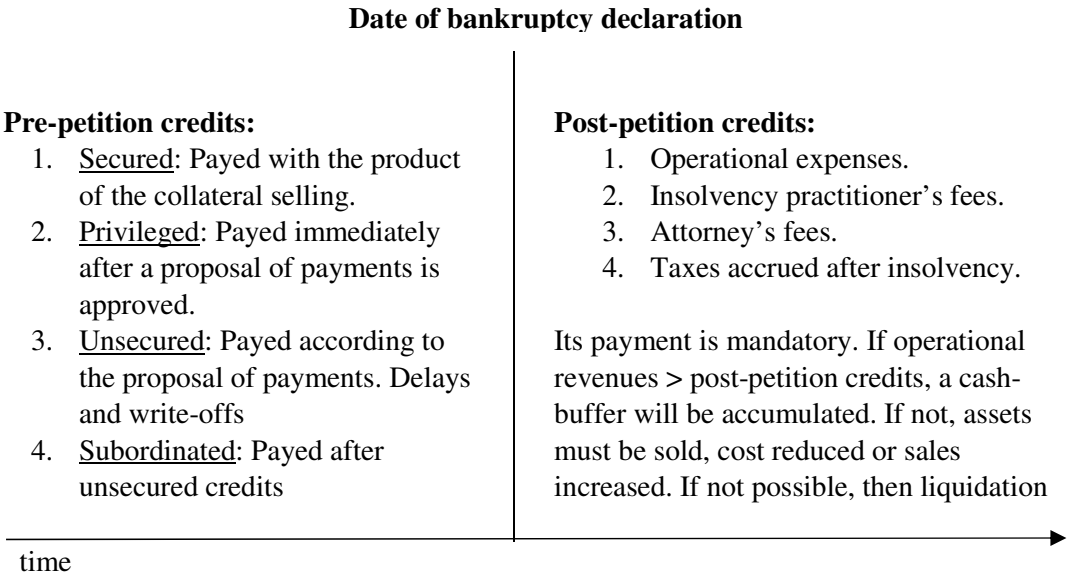
On the other side, creditors play a crucial role in the insolvency proceeding, since they are the principally damaged stakeholder (Gilson, 2010) and, at the same time, they must decide whether the firm survives or not. Therefore, their motivations to support (or not) the survival plan must be understood. There are different kinds of creditors, and their preference of return is varied as well, so it will be common to observe diverse degrees of implication in the proceeding depending on their seniority.

The law classifies the creditors into two main categories, regarding the origin and maturity of the credits they hold. A general picture of the debts classification rule is shown in Figure 3.2. In first place, post-petition credits (claims against the estate[13] – *créditos contra la masa*) are those accrued after the

[13] In spite of the difficulty to translate literally the credits nomenclature and classification, there is consensus among different legislations to divide the creditors between the five classifications here mentioned. The American and English bankruptcy regimes have been used in order to name the ranking of credits, based on Altman and Hotchkiss (2006).

bankruptcy declaration, and claimants of these debts do not vote the arrangement. The payment of these credits is mandatory for the firm, and include the operation expenses, the bankruptcy administrator's fee, attorney's fees and other expenses needed for the normal running of the business. Since the payment of these claims is preferential to other credits, post-petition credits holders are not considered to be involved in the process (Altman and Hotchkiss, 2006). Nonetheless, there are some exceptions, such as the "fresh money" provided by financial institutions (Gilson, 2010). The "fresh money" is classified as a post-petition credit but is normally borrowed contingent on a larger pre-petition debt recovery package in favor of the moneylenders, usually banks.

Figure 3.2. Debt classification in the Spanish bankruptcy procedure.



Source: Own elaboration.

On the other hand, pre-petition credits (*créditos concursales*) are divided into four categories (Fernández, 2004):

1. Secured credits (*créditos con privilegio especial*), are normally held by financial institutions, which have some collateral guarantying the payment of their debt. These credits are honored by selling the collateral or achieving a particular arrangement with the creditor in case that the collateral is needed for the business. They are not obliged to vote in favor of the arrangement, but they will be subjected to it in case they give their support.

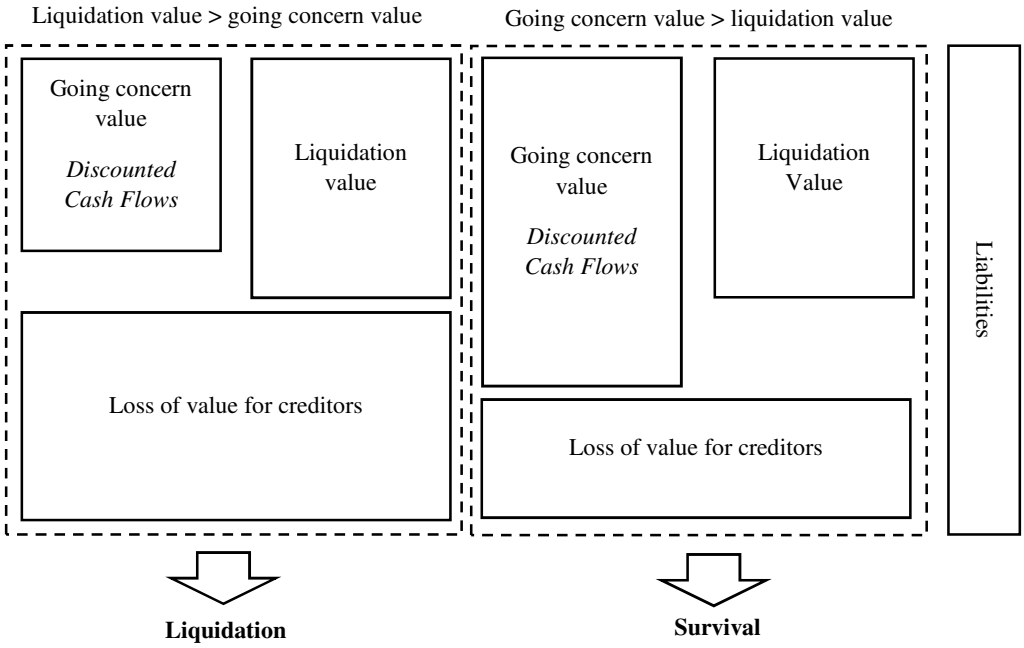
2. Privileged credits (*créditos con privilegio general*) are those with specific characteristics, and their payment is preferential to unsecured creditors. Under this category, it is common to find an important amount of the public creditors (at least the half of their credits is privileged) and the wages of the labor force, up to a specific limit. The privileged creditors are not obliged to vote the arrangement as well, but they will be equally subjected to it in case they vote in favor.
3. Unsecured credits (*créditos ordinarios*) are those not included in the previous categories, and are usually integrated by suppliers, unsecured financial institutions and the rest of the public credits and labor force. The arrangement of payments is proposed for these creditors. It is necessary that, at least, creditors amounting half of the unsecured liabilities vote in favor of the arrangement for it to be approved.
4. Subordinated credits (*créditos subordinados*) include unsecured interests, sanctions and credits from related parties (tipically shareholders). The subordinated credits have no right to vote, and they will be paid once the unsecured credits are satisfied, and in the same period as them.

Once bankruptcy is declared, the firm is only allowed to pay the post-petition credits, while the rest of payments remain frozen until a solution is achieved ("automatic stay"). If the firm is economically viable (Cook et al., 2011), it will be able to punctually attend the claims against the estate, since its revenue will exceed its ordinary expenses and the proceeding fees. If it is not able to pay the post-petition credits, it should sell assets, reduce expenses or increase revenues. In case that the firm adopts those measures and it is still unable to cover the post-petition credits, the firm should be liquidated (Gilson, 2010). On the contrary, if the firm is economically viable and able to satisfy post-petition credits, the prepetition credits are to be paid according the arrangement of payments, provided that its creditors give the necessary support.

Creditors usually face the going concern – liquidation dilemma (Altman and Hotchkiss, 2006; Gilson, 2010; LoPucki, 2003). As depicted in Figure 3.3, creditors must decide whether to save the firm or not comparing the net present

value of the firm as a going concern or being liquidated. In case that the net present value of the going concern is lower than the liquidation value, creditors will prefer liquidation to survival, and thus they will not support the viability proposal. On contrary, in the event that creditors estimate that the present going concern value is higher than the liquidation value, they will support the firm's survival.

Figure 3.3. Going concern – liquidation dilemma.



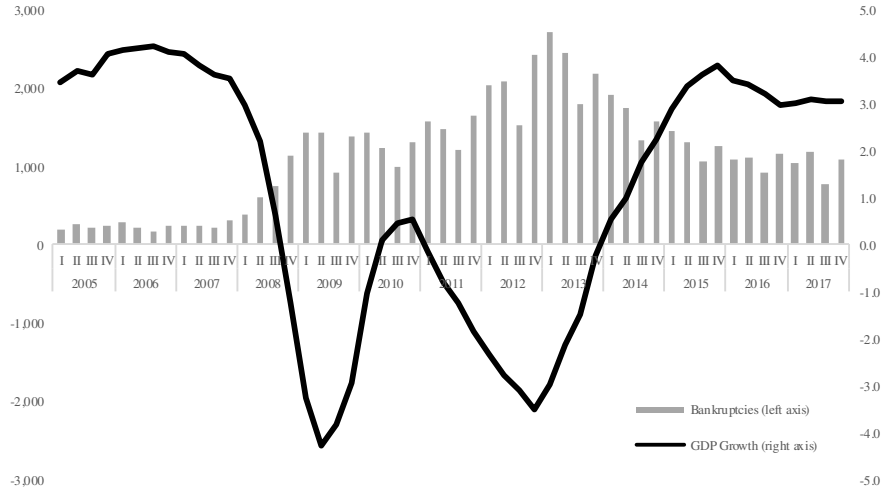
Source: Own elaboration.

However, this approach is not homogeneous within all categories of creditors, given the differences in the priority payment rule. Prior theory (Franks and Sussman, 2005) has argued that secured creditors (usually banks) are less inclined to support survival on the basis that their debts are collateralized by firm's assets, and consequently only take into account their collateral value rather than the rest of assets' value. This situation produces selfish and knee-jerk behaviors among secured creditors, who have the power to enforce collaterals to have their debts paid. However, such assets may also constitute the firm's base for future cash generation (Winn, 1997), thus such behaviors will probably lead to the firm disappearance.

3.3. Bankruptcies in Spain.

The population object of study were the Spanish bankrupt firms during the Great Recession. Since the enactment of the bankruptcy law (September 2004), the number of bankruptcies has multiplied (Figure 3.1), and a total amount of 59,136 firms have been declared bankrupt until the fourth quarter of 2017. Particularly, two sudden rises can be observed. The first one when the first recessionary period took place (ending 2008 to beginning 2010), in which bankruptcies increased from around 300 quarterly to 1,400 quarterly. The bankruptcy statistics maintained such figures until ending 2012, when the second recession occurred. The first quarter of 2013 registered the highest number in bankruptcies (2,709), just after the steepest point of GDP decrease during the second recession (-3.5%). From that quarter to the end of 2017, bankruptcy figures have substantially decrease, but still remain in the levels that reached when the Great Recession started. Thus, there is little evidence that such figures will reduce in the near future, similarly to what has been observed in more mature bankruptcy systems (Mokal, 2004).

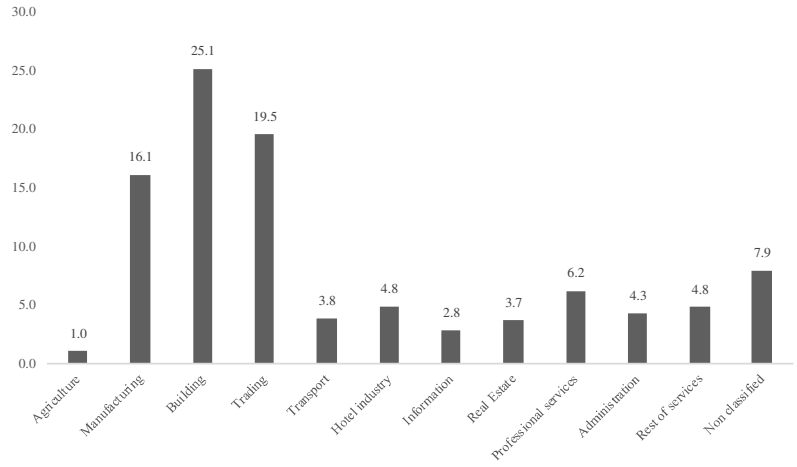
Figure 3.4. Bankruptcy figures and GDP growth (2005-17).



Source: Own elaboration based on data from INE (2017)

The industry breakdown of bankrupt firms shows a bias towards building firms (near 25.0% of average in the period 2012-15), as depicted in Figure 3.2. The second industry is trading (19.5%) followed by manufacturing firms (16.1%). Professional services (6.2%), along with rest of services (4.8%) and hotel industry (4.8) are the following industries by percentage. The rest of industries have a low weight in the total amount of bankruptcies (22.5% of total bankruptcies).

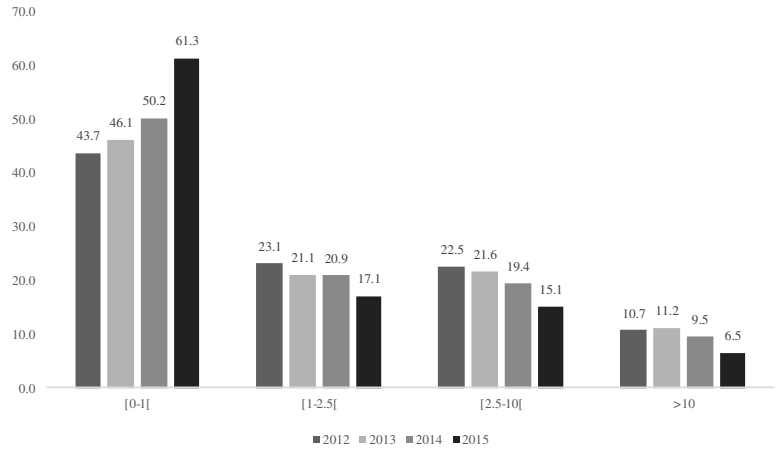
Figure 3.5. Industry breakdown of bankruptcies (average period 2012-15).



Source: Own elaboration based on data from INE (2017)

Bankrupt firms are also biased towards SMEs, and their size has decreased in recent years (Figure 3.3). From 2012 to 2015, the percentage of firms whose total assets are less than 1 million euros has increased from 43.7% to 61.3%. In the same period, firms whose assets are between 1 and 2.5 million euros have decreased from 23.1% to 17.1%, the same as firms with assets between 2.5 and 10 million euros (from 22.5% to 15.1%) and firms with assets higher than 10 million euros (from 10.7% to 6.5%).

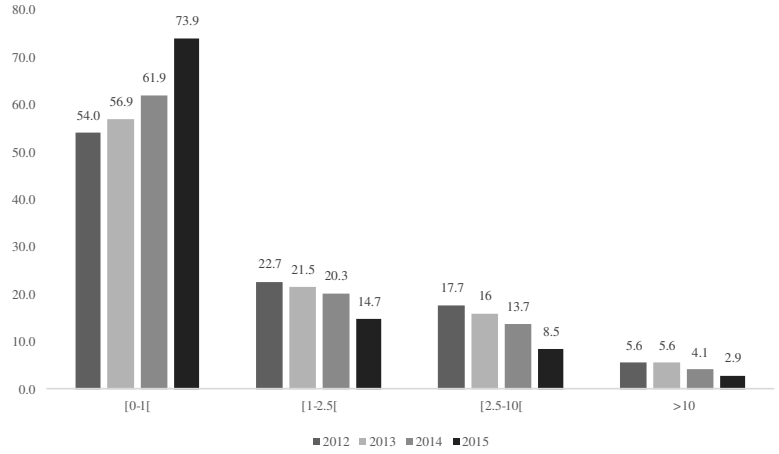
Figure 3.6. Distribution of bankrupt firms by total assets (2012-15).



Source: Own elaboration based on data from Van Hemmen (2014; 2015; 2016).

When observing the distribution of bankrupt firms by revenues, it can be also concluded that SMEs are predominant (Figure 3.4), and the percentage of small firms has substantially increased in this period. Firms with revenues under 1 million euros were 54.0% in 2012 and rose to 73.9% in 2015. In the rest of revenues segments the percentage of firms has decrease accordingly. Firms with revenues between 1 and 2.5 million euros started in 22.7% of the population in 2012 and ended in 14.7% in 2015. Similarly, firms with revenues from 2.5 to 10 million euros were 17.7% in 2012 and 8.5% in 2015 and, finally, firms whose revenues were higher than 10 million euros were 5.6% in 2012 but decreased to 2.9% in 2015.

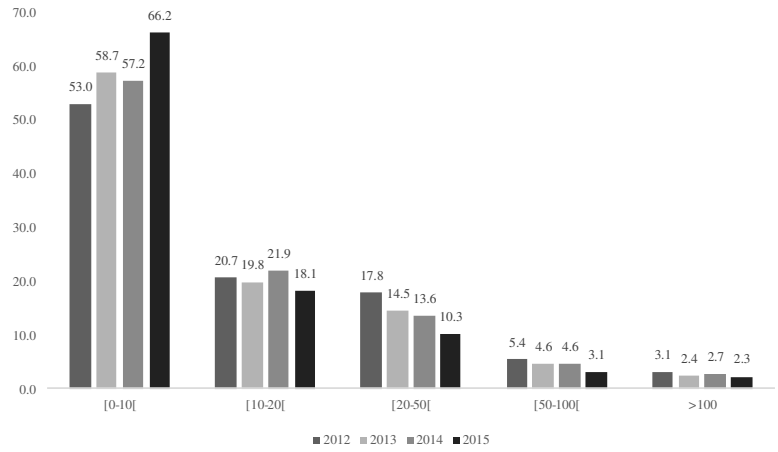
Figure 3.7. Distribution of bankrupt firms by total revenues (2012-15).



Source: Own elaboration based on data from Van Hemmen (2014; 2015; 2016).

The distribution by number of employees also confirms what it has been observed for assets and revenues, which is the concentration of SMEs and their percentage increase during the 2012-15 period, as shown in Figure 3.5. Firms with less than 10 employees represented 53.0% of the population in 2012 and increased to 66.2% in 2015. Firms with more than 10 but less than 20 employees were 20.7% and decreased to 18.1% in 2015. It happened the same to firms with employees between 20 and 50 (17.8% to 10.3%), 50 and 100 (5.4% to 3.1%), and more than 100 employees (3.1% to 2.3%).

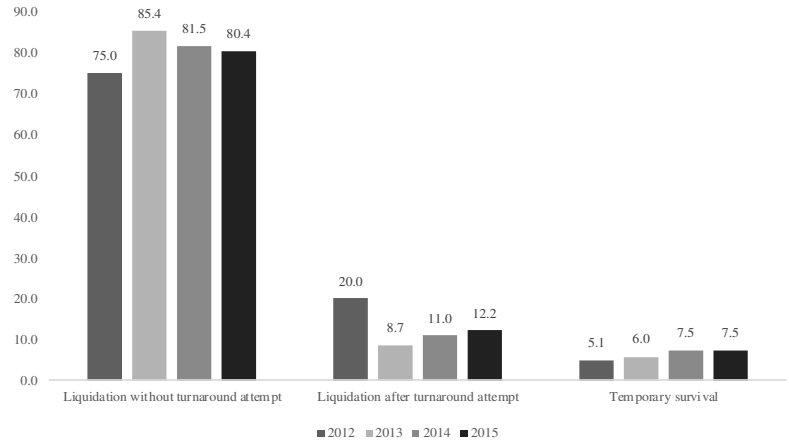
Figure 3.8. Distribution of bankrupt firms by employees (2012-15).



Source: Own elaboration based on data from Van Hemmen (2014; 2015; 2016).

When entering bankruptcy, firms initially can achieve three main outcomes. First, entering liquidation without attempting a turnaround, second, entering liquidation after attempting turnaround or, third, temporary survival. (as shown in Figure 3.6). The majority of bankrupt firms enter liquidation without even attempting a turnaround, and their proportion has increased from 2012 (75.0%) to 2015 (80.4%), as depicted in Figure 3.6. However, a decrease was observed from the peak point of 2013 (85.4%), probably because of the legislative changes. The second outcome, liquidation after attempting turnaround, was the outcome for 20.0% of firms in 2012, but then reduced to 8.7% in 2013 and slightly increased to 12.2% in 2015. Lastly, temporary survival was achieved by only 5.3% in 2012, but their percentage has increased to 7.5% in 2014 and the same proportion in 2015.

Figure 3.9. Distribution of firms by bankruptcy outcome (2012-15).



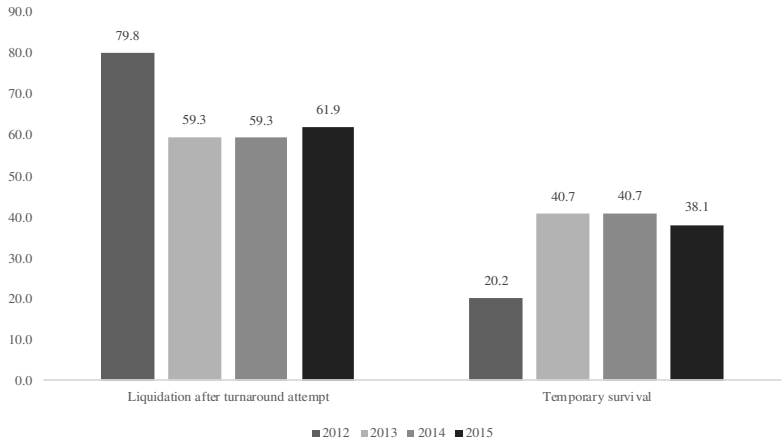
Source: Own elaboration based on data from Van Hemmen (2014; 2015; 2016).

Finally, two of the outcomes studied in this research are (1) liquidation after attempting turnaround and (2) temporary survival, so their figures have been isolated from liquidation without turnaround, which have no interest[14] when studying turnaround in bankrupt firms. For clarity sake, both outcomes have been defined as "liquidation" and "survival". In this sense, bankrupt firms attempting turnaround mainly end in liquidation, however their proportion has substantially changed in the 2012-15 period (Figure 3.7). While in 2012, 70.8% of bankrupt firms attempting turnaround were liquidated, almost 9 percentage points less suffered this outcome in 2015, and thus 38.1% of firms achieved temporary survival. Nonetheless, a slightly higher proportion of firms survived in 2013 and 2014 (40.7% of firms attempting turnaround).

There are no statistics measuring the performance of Spanish firms during bankruptcy, and consequently no comparison could be made with the sample of this research. In this respect, this thesis significantly contributes by providing deeper insights regarding the financial performance of bankrupt firms, an issue that has never measured before, as far as it is known.

[14] Firms that enter liquidation without attempting turnaround could be object of study, but in a stage prior becoming bankrupt. These firms have no expectations to be saved when entering the proceeding, but maybe their viability could have been restored previously, an issue for which business turnaround could also prove useful.

Figure 3.10. Distribution of firms by turnaround outcome (2012-15).



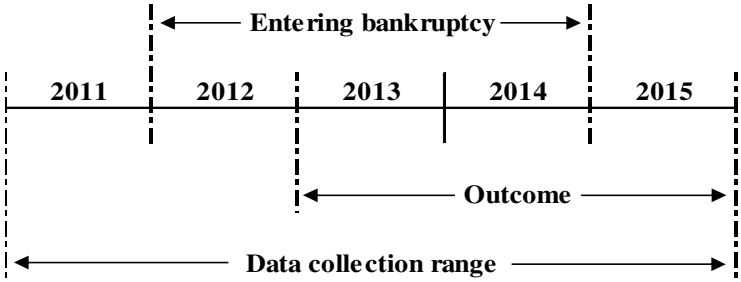
Source: Own elaboration based on data from Van Hemmen (2014; 2015; 2016).

3.4. Data collection and sample.

The major reforms of the Spanish bankruptcy proceeding started in 2011 (García-Posada and Vegas, 2016). As there is an interest in assessing the current regime, firms whose bankruptcy was declared prior to 2012 were discarded and the sample was drawn from the population of Spanish firms which entered bankruptcy in the period 2012-14 inclusive. At the point of the data collection the cut-off date of data was set to the end of 2015. Accordingly, firms reaching an outcome (liquidation or survival) between 2013-15 inclusive were included in the sample.

Therefore, data from 2011 (earlier year prior entering bankruptcy) and 2015 (later year after reaching an outcome) were obtained. Following Pozuelo et al. (2013), this period of data collection is highly appropriate for a study of bankrupt firms as the peak year for bankruptcy filings during the Great Recession occurred in 2013.

Figure 3.11. Analysis and data collection period.



Source: Own elaboration.

Data were extracted from the *Sistema de Análisis de Balances Ibéricos* (SABI) database. SABI contains financial information drawn from annual accounts of 2 million Spanish firms and half a million of Portuguese firms, obtained from the Public Commercial Register (*Registro Mercantil*). SABI offers the possibility to filter firms that have filed for bankruptcy and allows the separation of firms that survive and those that liquidate. Annual accounts from the year prior to the bankruptcy declaration and from the year of the turnaround outcome (survival or liquidation) were used to obtain the financial data. Each case included required published accounts for the duration of the proceeding and

a proceeding duration of at least two years to observe changes in the variables of interest.

Data on the bankruptcy declaration and the result of the procedure were obtained from both SABI and the Public Bankruptcy Register (*Registro Público Concursal*)[15]. The Register contains data on declaration date, survival and/or liquidation.

First, data from SABI were extracted by applying the filter "status". Then, dates of declaration and liquidation or survival were obtained from the Register. Only cases that achieved either survival or liquidation were selected, excluding those whose proceeding had not arrived at one of these outcomes. It is possible that a selected firm was still under the bankruptcy regime, but only if it was being liquidated. In that case, its turnaround attempt is over although the formal proceeding had not been completed.

Residential and related building activities, as well as sports clubs, state-held and holding firms, were excluded, since their financial structure might distort the variables of interest. In the residential building industry, buildings are considered inventory. However, in reality a large amount of these current assets has become fixed due to the financial crisis. There is also a bias towards building and related activities in the Spanish bankruptcy context, and the majority of them are liquidated (Van Hemmen, 2016). Sports clubs and holding firms have some particularities that make their exclusion advisable (Rico and Puig, 2015). Public or state companies were also excluded, since the proceeding to turn them around differs significantly from that for privately held firms (Boyne, 2004; Jas and Skelcher, 2005).

Initially, 2,387 bankrupt firms were found on the SABI database. From these, 685 met the criteria for inclusion. Firms with missing data were also excluded. The final sample consisted of 599 firms. Of these, 302 (50.4%) survived and 297 (49.6%) were liquidated. By industrial classification, the sample contained 236 (39.4%) manufacturing firms, 176 (29.4%) services firms, 134 (22.4%) trading firms and 53 (8.8%) firms from other industries. In this

[15] www.publicidadconcursal.com

sample, manufacturing firms are over-represented, as depicted in Table 3.1. While in the whole Spanish economy they are the 4.4% of total firms, they represent the 13.2% of bankrupt firms. Services firms, which have a weight of 47.2% of total firms in the Spanish economy and 54.3% of bankrupt firms, are under-represented in the sample.

Table 3.1. Industry breakdown in the Spanish economy, bankrupt firms' population and firms in the sample.

Industry	Firms in the Spanish economy (%)[a]	Spanish bankrupt firms (%)[a]	Firms in the sample (%)
Manufacturing	4.4	13.2	39.4
Services	47.2	54.3	29.4
Trading	19.0	23.9	22.4
Other	29.4	8.6	8.8
Total	**100.0**	**100.0**	**100.0**

a. Residential building has been excluded to obtain the figures and homogenize with the sample criteria.
Source: Own elaboration based on INE (2017), Van Hemmen (2016) and SABI.

The sample is biased towards firms that file for bankruptcy which are likely to have more turnaround potential than the majority that cease trading without filing (number 2 of Figure 3.1), as shown by Van Hemmen (2016). In his records, the author found that manufacturing firms had the highest survival rates (17.9%), almost twice the other industries (building 10.2% and services 9.6%). This problem has been encountered in similar studies of Spanish firms (Camacho-Miñano et al., 2015; Pozuelo et al., 2013). Average assets of the sample were €9.5 million, over the average (€6.3 million) observed in the years 2012 and 2013 by Van Hemmen (2014), showing a bias towards larger firms, those with higher likelihood of survival. Of the 599 firms in our sample, 99% are SMEs according to the number of employees' criteria of the European Union definition (651/2014)[16], as depicted in Table 3.2.

[16] According to the Commission Regulation (EU) No 651/2014, SMEs are those firms employing less than 250 employees and either with revenues under €50 million or balance-sheet under €43 million. Criteria to distinguish a small from a medium sized firm are having less than 50 employees and either revenues under €7 million or balance-sheet under €5 million. Micro firms are those that have less than 10 employees and whose revenues or balance-sheet are less than €2 million.

Table 3.2. Size breakdown in the Spanish economy, bankrupt firms' population and firms in the sample (employees' number criteria).

Size	Firms in the Spanish economy (%)[a]	Spanish bankrupt firms (%)[a]	Firms in the sample (%)
Micro [0-10[	90.71	57.2	38.9
Small [10-50[	7.72	35.4	47.2
Medium [50-250[	1.21	4.6	12.7
Large >250	0.35	2.7	1.2
Total	**100.0**	**100.0**	**100.0**

Source: Own elaboration based on INE (2017), Van Hemmen (2016) and SABI.

3.5. Analysis measurements.

Dependent variable

Outcome. A multinomial logistic regression was performed in which the dependent variable was the three possible outcomes of the turnaround process within bankruptcy. As Åstebro and Winter (2012) found, the binary logistic model is normally mis-specified, and the multinomial model offers further alternatives for analysis. As found by the authors, a dummy variable seems inappropriate to capture the nuances of turnaround in a bankruptcy procedure. During bankruptcy, firms can be liquidated or achieve survival. Additionally, surviving firms can restore their performance or not (Eberhart et al., 1999). Consequently, three possible outcomes were defined: liquidation, marginal survival and successful survival. Liquidation is defined as the failure outcome, the one in which a firm does not survive. In this event, the variable took the value of 1. Marginal survival was defined when a firm achieved survival, but did not improve pre-bankruptcy performance, thus the variable was given the value of 2. In the event that a firm achieves survival and improves its prior performance, a successful survival is defined, and the variable took the value of 3.

Independent variables

Following the retrenchment-recovery model by Robbins and Pearce (1992), retrenchment and recovery responses were captured separately. Firstly, from the year prior bankruptcy until they ceased, retrenchment strategies were measured. Only when retrenchment ended, recovery strategies were measured. It could occur that a bankrupt firm did not ceased retrenching during the procedure, thus no recovery actions were detected.

Retrenchment response. This variable measures the intensity of *retrenchment* in *costs* and *assets*. For measuring retrenchment, the average percent variation between the two years prior bankruptcy and the two years in which retrenchment actions ended (Robbins and Pearce, 1992) of the following variables was calculated. For measuring cost retrenchment selling, general and administration costs (SGA) were captured (Lim et al., 2013). The firm's total assets was used to address asset retrenchment strategies (Morrow et al., 2004).

To measure the intensity of the strategies adopted a 0-2 point scale was defined, on the grounds of the common thresholds found in the literature. The variable took the value of 0 if no retrenchment or up to a 5% reduction was calculated. This limit was chosen, guided by Lim et al., (2013), given that a variation of 5% of any of the measures could be derived from the normal operation of the business, and not necessarily from a firm's discretionary action. This level of retrenchment has been also defined as "weak" in subsequent sections of the research. When the reductions were among 5% and 25% the variable took the value of 1 (also "moderate" retrenchment). The threshold of 25% was defined in prior bankruptcy studies (Moulton and Thomas, 1993) as an excessive reduction. Finally, the variable took the value of 2 when the reduction of costs, employees or assets was above 25% ("deep" retrenchment). This way of coding allows to capture the level and intensity of the retrenchment measures while taking a more fine-grained approach than some prior studies (Ndofor et al., 2013).

Recovery response. This variable measures the intensity of *recovery* in *sales* and *investment*. For measuring recovery, the average percent variation between the two years after adopting retrenchment and the two years in which an outcome was reached was calculated for the following variables. For measuring sales increase, sales variation was captured (Bruton et al., 2003). Investments were measured as the increase in assets as above defined (Ndofor et al., 2013). The same thresholds used for retrenchment strategies (0-2 scale) were employed to measure the intensity of recovery actions.

Control variables

Drawing from BT literature, time, size, belonging to an industry, slack, prior performance and competitive environment are expected to have an effect on the firm's reorganization and subsequent performance. Therefore, the models have been controlled by all of these variables.

Time. Time spent in the proceeding has been frequently controlled for in prior bankruptcy and turnaround literature (Balcaen et al., 2011; Kahl, 2002). Van Hemmen (2009) found that duration is normally related to the inefficiency

of the Spanish bankruptcy procedure. In his subsequent analysis the author reveals that longer durations are observed for larger firms and for those entering into liquidation. As a consequence, creditors may consider that the duration of the proceeding will reduce their prospects of being paid back. However, a longer duration is also beneficial for the firm, if it has been able to stabilize its operations (Claessens and Klapper, 2005). The automatic stay period provides with valuable time to generate cash to subsequently employ it for debt repayment. Consequently, time is expected to be positively associated to the chances of turnaround. Time is measured as the number of years since bankruptcy is declared until an outcome is reached, and a 0-3 scale was built. The value of 0 was given to turnaround attempts that lasted less than 1 year, and the value of 3 to those that spent 3 or more years in the procedure, the average threshold for turnaround attempts in bankruptcy (Van Hemmen, 2016).

Size. Previous research has addressed the influence of firm size and age on survival prospects and conclude that larger and older firms are more likely to subsist (Cater and Schwab, 2008; Schmitt and Raisch, 2013; Thornhill and Amit, 2003). Large firms are able to raise unsecured capital and assets generated by such borrowing provide collateral for additional borrowing (Routledge and Gadenne, 2000), so they can enjoy, not only a wider resource-base, but also a higher level of slack resources. Additionally, some authors (Altman and Hotchkiss, 2006; Camacho-Miñano et al., 2015) acknowledge the existence of an economy of scale with respect to bankruptcy costs. Those costs are comparatively higher for SMEs than for larger firms, since an important amount of the proceeding's expenses are fixed. Consequently, larger firms are better prepared to face a bankruptcy procedure than smaller ones, as Van Hemmen (2016) records point out.

Size has been captured in a 1-3 scale, being 1 the value for micro firms, 2 for small firms and 3 for medium and large firms, according to quantitative criteria from Regulation (EU) No. 651/2014 from the European Commission.

Industry. The industry to which the bankrupt firms belongs has been a common control variable, given its importance for the final outcome (Lim et al., 2013; Morrow et al., 2004; Robbins and Pearce, 1992). While some studies tried

to homogenize the industry of their samples (Bruton et al., 2003; Ndofor et al., 2013; Robbins and Pearce, 1992), others mixed a variety of industries and controlled for this variable (Lim et al., 2013; Morrow et al., 2004; Tangpong et al., 2015), in order to capture the differences between them. This variable has been defined as dichotomous distinguishing between manufacturing firms and services and trading firms. The distinctive characteristics of both groups, observed in prior studies (Chowdhury and Lang, 1994; Morrow et al., 2004), make advisable to divide between those two.

Manufacturing firms are more physical capital intensive (plant and equipment, machinery, etc), while services and trading firms have a higher proportion of labor force. As a result, belonging to a specific industry will have critical consequences for the adopted measures (Morrow et al., 2007; Chakrabarti, 2015). Also, Camacho-Miñano et al. (2015) encountered that manufacturing firms had a higher and substantial likelihood of survival when facing bankruptcy in Spain, while trading firms presented the lowest success rates (except for residential building). For the purpose of this research, manufacturing firms have been given the value of 1, while services and trading firms were assigned the value 0.

Slack. Prior analyses from the BT field have frequently controlled the firm's available resources, which could impact its ability and motivation to take decided action (Morrow et al., 2004; Morrow et al., 2007; Ndofor et al., 2013; Schmitt and Raisch, 2013). The most common indicator for financial funds availability was financial slack which, as defined by Burgeois (1981), it is a measure of unused resources that could be devoted to significant strategic change. Financial slack could be expressed with varied measures: debt to equity ratio, gross margin, working capital to total assets, liquidity ratio, etc. In this research, following previous turnaround studies, working capital (current assets – current liabilities) was chosen as a slack indicator (Morrow et al., 2004; Morrow et al., 2007). In general, higher working capital will imply a greater resources buffer, while a reduced one will signal the contrary. To capture it, in case that working capital was positive, it took a value of 1, and 0 otherwise.

Prior performance. One of the main motivations for a declining firm to act is a declining performance (Robbins and Pearce, 1992). This constitutes the clearest indicator of a turnaround situation as defined by turnaround scholars (Hofer, 1980). If a declining performance is observed and persists over time, it its more likely that the firm starts implementing turnaround measures. Consequently, performance prior to bankruptcy has been controlled for, since it captures the internal state of the firm, which may impact the turnaround process, thereby affecting subsequent performance (Lim et al., 2013). As done by Tangpong et al. (2015) firm's industry-adjusted ROA was captured as an indicator for prior performance. Previous studies have found contradicting associations between prior performance and subsequent turnaround (Morrow et al., 2007; Ndofor et al., 2013). To measure the variable, if industry-adjusted ROA took a positive value, then a 1 was given, while 0 otherwise.

Environment. The competitive environment is of great importance in turnaround attempts (Hofer, 1980; Morrow et al., 2004; Ndofor et al., 2013). Prior studies have been mainly focused on one-single industry or similar industries with similar economic conditions. However, despite the sampled used in this research only contains bankrupt firms, several industries are represented and, as hypothesized, the competitive environment is expected to have an impact on the effectiveness of turnaround strategies. Similarly to Schmitt and Raisch (2013), the competitive environment was classified into two groups. Industries whose median ROA for the period 2012-15 was above the median ROA for non-financial Spanish firms (BdE, 2016) in the same period (0.02) were classified as *munificent* (1). Conversely, industries with a ROA below 0.02 were classified as *stagnating or declining* (0). The additional separation of stagnating and declining did not provide different results than aggregating them.

All the variables employed in the analyses are summarized in Table 3.3, where the distribution between the different values are also put forward.

Table 3.3. Variables description.

Variable	Type	Values (% in the sample)
Outcome	Dependent	1 = Liquidation (49.6%) 2 = Marginal (28.0%) 3 = Success (22.4%)
Cost retrenchment	Independent	0 = Weak (<5%) (36.4%) 1 = Moderate (5-25%) (8.2%) 2 = Deep (>25%) (55.4%)
Asset retrenchment	Independent	0 = Weak (<5%) (33.6%) 1 = Moderate (5-25%) (35.7%) 2 = Deep (>25%) (30.7%)
Sales increase	Independent	0 = No (<5%) (79.1%) 1 = Moderate (5-25%) (8.9%) 2 = High (>25%) (12.0%)
Investments	Independent	0 = No (<5%) (84.6%) 1 = Moderate (5-25%) (10.0%) 2 = High (>25%) (5.4%)
Time	Control	0 = Less than 1 year (24.2%) 1 = Between 1 and 2 years (31.9%) 2 = Between 2 and 3 years (33.0%) 3 = More than 3 years (10.9%)
Size	Control	1 = Micro firm (60.3%) 2 = Small firm (31.2%) 3 = Medium and large firm (8.5%)
Industry	Control	0 = Services and trading (52.3%) 1 = Manufacturing (47.7%)
Slack	Control	0 = Working capital < 0 (52.8%) 1 = Working capital > 0 (47.2%)
Prior performance	Control	0 = Industry-adjusted ROA < 0 (77.6%) 1 = Industry-adjusted ROA > 0 (22.4%)
Environment	Control	0 = Stagnating or declining (51.4%) 1 = Munificent (48.6%)

Source: Own elaboration.

The three turnaround outcomes (liquidation, marginal and success) were compared, as depicted in Table 3.4. Successful firms spent longer time in the procedure (1.80 years), slightly more but non-significantly than marginal ones (1.65 years), and much longer and significantly than liquidated firms (0.95; $p<0.01$). Regarding size, both marginal (1.74 vs 1.28; $p<0.01$) and successful firms (1.61 vs 1.28; $p<0.01$) showed larger sizes than liquidating firms. The difference among them, though, proved to be non-significant. Also, marginal (0.58 vs 0.37; $p<0.01$) and successful firms (0.59 vs 0.37; $p<0.01$) had a higher

proportion of manufacturing firms than liquidating ones, while there were no significant differences between them. Besides, firms that were liquidated had significant lesser slack than marginal (0.29 vs 0.64; p<0.01) and successful firms (0.29 vs 0.67; p<0.01). Survivors that improved performance did not have significantly different slack than those that did not improved performance. Pre-bankruptcy performance for liquidating firms was significantly greater than marginal survivors (0.26 vs 0.15; p<0.01) and similar to successful ones. Between successful firms and marginal survivors there were also statistical differences (0.24 vs 0.15; p<0.05). The competitive environment was similar for liquidating and marginal survivors, slightly towards stagnating and declining ones (0.45). Conversely, successful firms operated significantly in munificent environments (0.60; p<0.01).

Table 3.4. Mean comparison by outcome.

Variable	Liquidate	Marginal	Success	Liquidate vs Marginal	Liquidate vs Success	Marginal vs Success
Time	0.95	1.65	1.80	***	***	
Size	1.28	1.74	1.61	***	***	
Industry	0.37	0.58	0.59	***	***	
Slack	0.29	0.64	0.67	***	***	
Prior performance	0.26	0.15	0.24	***		**
Environment	0.45	0.45	0.60		***	***
Cost retrenchment	1.01	1.23	1.55	**	***	***
Asset retrenchment	1.14	0.93	0.65		***	***
Sales increase	0.25	0.31	0.54		***	***
Investments	0.16	0.18	0.35			***

*$p < 0.10$; ** $p < 0.05$; *** $p < 0.01$
Source: Own elaboration.

Retrenchment strategies showed inverse results. On one hand, cost retrenchment intensity was significantly different between the three groups. Successful firms were the ones that retrenched more intensely, more than marginal (1.55 vs 1.23; p<0.01) and liquidating (1.55 vs 1.01; p<0.01). Marginal survivors also retrenched more deeply than liquidating (1.23 vs 1.01; p<0.05). On the other hand, successful firms took weaker asset retrenchment in mean, significantly less than marginal (0.65 vs 0.93; p<0.01) and liquidating firms (0.65 vs 1.14; p<0.01). There were no significant differences between marginal survivors and liquidating firms, although liquidating ones reduces assets more intensely. Regarding recovery strategies, more intense repositioning measures

were observed among successful firms. Firstly, successful ones had higher and significantly sales growth than marginal survivors (0.54 vs 0.31; $p<0.01$) and liquidating firms (0.54 vs 0.25; $p<0.01$). No significant differences were found between marginal survivors and liquidated firms regarding sales. And secondly, successful firms were also the ones that invested more intensely in comparison with marginal survivors (0.54 vs 0.31; $p<0.01$) and firms that were liquidated (0.35 vs 0.16; $p<0.01$). In summary, substantial distance could be observed particularly between successful and liquidating firms, while mainly structural factors and cost retrenchment actions distinguished marginal survivors from firms that were liquidated.

3.6. Statistical methods.

Given the categorical dependent variable, a maximum likelihood estimation of a multinomial logistic regression was performed to determinate the probability of the turnaround outcome (liquidation, marginal survival or successful survival). Particularly, the analysis was performed to predict the turnaround outcome as a function of retrenchment responses, subsequent recovery actions and control variables. Additionally, a multinomial logistic regression was used to predict the existence of the predicted moderating effect of the competitive environment.

The multinomial logistic regression was used attending to the characteristics of the dependent variables (categorical and non-dichotomous) and the categorical independent and control variables. The statistical method can incorporate a wide range of diagnostics and has been widely used in recent turnaround studies which mainly rely on accounting data (Bruton et al., 2003; Collet et al., 2014; Lim et al., 2013; Tangpong et al., 2015) and firm survival in Spanish studies (Esteve et al., 2004; Manjón-Antolín and Arauzo-Carod, 2008). Besides, using a multinomial logistic regression yields two benefits. Firstly, it exists a better comparability with extant literature. And second, the model is more robust than multivariate discriminant analysis, an alternative method (Ohlson, 1980). On the other hand, the probit regression model could have been a valid alternative, since "both models are very similar and rarely lead to different qualitative conclusions" (Bhimani et al., 2010: 525).

Additionally, The multinomial logistic regression allows for integrating more than two results (three in this research) and measuring the marginal contribution of each of the categories defined for the proposed variables (Ghauri and Grønhaug, 2005; Hair et al., 2006). In this sense, as the binary logistic regression measures the sign of the relationship between the dependent and independent variables, the multinomial logistic regression measures the sign, but it also compares the contribution of each category to the changes of the dependent variable (Åstebro and Winter, 2012).

3.7. Conclusions.

To test the proposed hypotheses in order to confirm the proposed conjectures on the impact of retrenchment and recovery responses and the competitive environment on turnaround attempts of Spanish bankrupt firms, two statistical analysis were carried out.

Spanish bankrupt firms in the period 2012-15 were chosen as the population object of study. Both bankrupt firms and the Spanish context have been ignored in prior turnaround studies, so by choosing such setting it was aimed to shed light on an understudied environment with future research potential. Recent regulatory trends in the EU context as well as the US bankruptcy model (Chapter 11) point out that it is worthier to save firms rather than destroying them and creating other ones. This is the case in Spain, where the bankruptcy procedure shows a very low efficacy (7% of firms survive) and a lower usage than in comparative developed countries. In order to extend the strategies adopted by surviving firms to the rest of future bankrupt firms, an analysis of the measures adopted has been taken using the BT framework. The analyses provide evidence on the effectiveness of varied retrenchment and recovery strategies and helps to fill a gap in the turnaround literature, the neglect of bankrupt firms in prior studies.

A sample of 599 Spanish bankrupt firms was gathered. Turnaround strategies adopted by these firms, their intensity as well as the impact of the competitive environment were studied in the period that their bankruptcies occurred until an outcome (survival – marginal or successful – or liquidation) was reached. Multinomial logistic regression was the chosen method in the empirical analyses.

Chapter 4. Analyses, results and discussion

Introduction.

The present chapter shows the findings of the empirical analyses carried out in this research and it is structured in two sections. In the first one, statistical results and operation variables used in the analyses are displayed. Two empirical tests were carried out, the first one assessing the effectiveness of retrenchment and recovery strategies in the probability of a successful turnaround, and the second one was run to evaluate the moderating impact of the competitive environment on the effectiveness of turnaround strategies on the outcome (liquidation, marginal survival or successful survival). The second section deals with the main findings extracted from the analysis and their implications to the study are discussed.

This structure responds, not only to the aim to validate the hypotheses proposed from the literature review, this is, study the effectiveness of retrenchment and recovery responses and the moderating role of the competitive environment in bankrupt firms and their effect in subsequent performance. The intention is also to reveal the potential value of the empirical results as well as extending the current knowledge on BT strategies.

4.1. Analytical results.

Before running the multinomial logistic regression analyses, means, standard deviations and correlations between the selected variables were checked, all of them displayed in Table 4.1. In general, no correlation problems are evident, since statistically significant Pearson correlations are few and lower than 0.5. Besides, the majority of them are shown by the dependent variable, being the highest one shown by the variables *time* and *slack* with *outcome*. Apart from the dependent variables, *time* is the only variable that shows significant correlations with most of the rest of variables. Additionally, *investments* and *asset retrenchment* are highly and negatively correlated, as it could be expected given the contradictory nature of the variables.

An additional test on variance inflation factors (VIF) was carried out, in order to examine the possible presence of multicollinearity problems of the explanatory variables. The VIF values for all the variables were slightly higher than 1, lower than the commonly accepted multicollinearity threshold (5), and tolerance values higher than 0.5. These results point out that no multicollinearity problems are present in the analysis (Hair et al., 2006).

In line with the proposed model, Tables 4.2 through 4.10 show the results of the multinomial logistic regressions analyses as estimated with SPSS-20. In the first three tables (Test I) the impact of retrenchment and recovery strategies on the turnaround outcomes (*liquidation*, *marginal survival* and *successful survival*). In the subsequent six tables (Test II), the moderating effect of the competitive environment is measured, comparing the three possible outcomes of the turnaround within the bankruptcy procedure. The followed method was the one described by Åstebro and Winter (2012).

Table 4.1. Descriptive statistics

#		Mean	S.D.	1	2	3	4	5	6	7	8	9
1	Outcome	1.73	0.80									
2	Time	1.31	0.96	0.38***								
3	Size	1.48	0.65	0.25***	0.28***							
4	Industry	0.48	0.50	0.19***	0.18***	0.30***						
5	Slack	0.47	0.50	0.34	0.14	0.27***	0.17 ***					
6	Prior performance	0.22	0.42	-0.04***	-0.04***	-0.12	-0.09 **	0.05				
7	Cost retrenchment	1.19	0.94	0.19***	0.14	0.06***	0.04	0.12 ***	-0.19 ***			
8	Asset retrenchment	0.97	0.80	-0.24***	-0.08***	-0.03	-0.05	-0.19	-0.03	-0.04		
9	Sales increase	0.33	0.68	0.16**	0.09**	-0.01	0.02	0.05***	-0.01	-0.11	-0.25 ***	
10	Investments	0.21	0.52	0.14***	0.00	-0.08**	-0.09**	0.04	0.06	-0.08***	-0.48***	0.34 ***

*$p < 0.10$; ** $p < 0.05$; *** $p < 0.01$

4.1.1. The effectiveness of turnaround strategies (Test I).

To display the results of the multinomial logistic regression, five models were defined in the subsequent tables. Model 1 includes the prediction results only using control variables, while Models 2-4 address the isolated effects of independent variables. Model 2 evaluates the impact of retrenchment; Model 3 reports recovery effects and Model 4 incorporates includes all the variables. The estimated coefficient (β_i), its significance (*) and the standard error (S.E.) were calculated, in order to interpret the magnitude of the relationship between each independent and control variables with the dependent one. The coefficients indicate to which extent the analyzed variable contributes to the reference dependent variable. In Model 1 of Table 4.2, for instance, the coefficient of *time* (0.72, $p<0.01$) would be interpreted as: "time positively contributes to marginal survival in comparison to liquidation". In this case, the reference dependent variable is *liquidation*.

In Table 4.2, the comparison between liquidation (reference) and marginal survival is presented. Model 1 only includes control variables, whose results are consistent throughout all the models in the table. The models present all high explanatory power and highly significant chi squares (Model 1: 200.67, $p<0.01$; Model 2: 24.41; $p<0.01$; Model 3: 221.71, $p<0.01$; Model 4: 260.40, $p<0.01$). The accuracy of the models was relatively high (Model 1: 58.60%; Model 2: 59.30%; Model 3: 59.40%; Model 4: 61.10%). Apart from Model 4, the model that better explained the probability of survival in the bankruptcy procedure was Model 2, signaling that *retrenchment* is one of the keys for surviving the procedure. *Cox and Snell*, *Nagelkerke* and *McFadden* R^2 along with chi squares and -2 Log likelihood showed that the explanatory ability of the models increased when the independent variables were added. The subsequent Tables 4.3 and 4.4 present the same explanatory power and significance, as well as accuracy, given that the underlying models are the same, but they compare different outcomes.

The results of Table 4.2 show that *time* (0.72; $p<0.01$), *size* (0.65; $p<0.01$) and *slack* (1.31; $p<0.01$) had a positive impact for firm survival. *Prior performance* showed a negative impact (-0.68; $p<0.05$) signaling that liquidating

firms had higher performance than those which survived marginally, but they were unable to reverse decline. *Industry* was significant only in Model 2 (0.31; p<0.10), when *retrenchment* strategies were evaluated (Model 2), being non-significant in the rest of models. Regarding, *retrenchment* actions the expected positive sign was found for *cost retrenchment*, however it proved non-significant. In contrast, *asset retrenchment* showed the expected and significant negative sign (-0.27; p<0.10). On the other hand, for both *recovery* strategies (*sales increase* and *investments*) the predicted positive signs were reported, nevertheless they were non-significant (Model 3). Finally, when evaluated the combination of *retrenchment* and *recovery* strategies within bankruptcy (Model 4), none of them was significant, despite the analysis showed the hypothesized signs. This means that turnaround strategies proved inefficient when distinguishing firms that were liquidated from those that survived with no performance improvement.

Table 4.2. Results of the multinomial logistic regression – marginal vs liquidation.

	Model 1	**Model 2**	**Model 3**	**Model 4**
Time	0.72***	0.71***	0.74***	0.72***
	(0.13)	(0.13)	(0.13)	(0.13)
Size	0.65***	0.67***	0.68***	0.69***
	(0.18)	(0.18)	(0.19)	(0.19)
Industry	0.29	0.31*	0.33	0.34
	(0.23)	(0.23)	(0.23)	(0.23)
Slack	1.31***	1.24***	1.29***	1.24***
	(0.23)	(0.23)	(0.23)	(0.23)
Prior performance	-0.68**	-0.64**	-0.70**	-0.65**
	(0.28)	(0.29)	(0.29)	(0.29)
Cost retrenchment		0.11		0.11
		(0.12)		(0.12)
Asset retrenchment		-0.27*		-0.22
		(0.14)		(0.16)
Sales increase			0.09	0.07
			(0.18)	(0.18)
Investments			0.29	0.15
			(0.24)	(0.27)
Constant	-3.03***	-2.90***	-3.19***	-3.05***
	(0.33)	(0.39)	(0.35)	(0.43)
Observation	599 (465)	599 (465)	599 (465)	599 (465)
R^2 (Cox and Snell)	0.29	0.34	0.31	0.35
R^2 (Nagelkerke)	0.33	0.39	0.35	0.40
R^2 (McFadden)	0.16	0.20	0.18	0.21
-2 Log likelihood	388.67	718.16	616.01	825.60
Chi square	200.64***	247.41***	221.71***	260.40***
Correctly classified	58.60%	59.30%	59.40%	61.10%

Note: * p<0.10; ** p<0.05; *** p<0.01.

In Table 4.3 the results of the multinomial logistic regression comparing liquidation (reference) and successful survival are presented. Model 1 includes only control variables, while Models 2-4 evaluate the proposed turnaround strategies. They also present the same explanatory power, chi square and accuracy than those of Table 4.2, given that the underlying models are the same, but they compare different outcomes. The R^2 are also equivalent to those of Tables 4.2.

Model 1 showed similar results of those comparing liquidation and marginal success. *Time* (0.98; p<0.01) and *slack* (1.52; p<0.01) maintained their positive association with survival. Additionally, *industry* proved a significant and positive relationship (0.45; p<0.10), thus confirming that belonging to a manufacturing industry yielded a higher probability of success. In contrast, *size* was non-significant in Model 1, but acquired significance in the rest of models. On the other hand, *prior performance* showed no significant association with successful survival.

The results for *retrenchment* strategies presented the expected results. While *cost retrenchment* was positively related with success (0.65; p<0.01), *asset retrenchment* showed the contrary result (-0.83; p<0.01), thus being detrimental for the bankrupt firm's success. The expected positive association with successful turnarounds was also conveyed by *recovery* actions. Both *sales increase* (0.38; p<0.05) and *investments* (0.70; p<0.01) contributed to survival and performance improvement. However, some nuances aroused when turnaround strategies were evaluated at the same time. *Cost* (0.74; p<0.01) and *asset retrenchment* (-0.62; p<0.01) as well as *sales increase* (0.47; p<0.01) maintained their signs and significance, while *investments* lost the strength of the statistical relationship despite the positive expected sign. This might suggest that *investments* were not decisive in successful turnarounds when *cost retrenchment* actions and *sales increase* strategies were adopted, while at the same time the firm preserved its assets (did not implement *asset retrenchment* measures).

Table 4.3. Results of the multinomial logistic regression – success vs liquidation.

	Model 1	Model 2	Model 3	Model 4
Time	0.98***	1.00***	0.99***	1.00***
	(0.14)	(0.15)	(0.14)	(0.15)
Size	0.30	0.40*	0.38*	0.44***
	(0.20)	(0.21)	(0.21)	(0.15)
Industry	0.45*	0.42	0.52**	0.47*
	(0.25)	(0.26)	(0.25)	(0.26)
Slack	1.52***	1.30***	1.51***	1.31***
	(0.25)	(0.26)	(0.25)	(0.26)
Prior performance	-0.17	0.07	-0.21	0.09
	(0.28)	(0.31)	(0.29)	(0.31)
Cost retrenchment		0.65***		0.74***
		(0.15)		(0.15)
Asset retrenchment		-0.83***		-0.62***
		(0.17)		(0.19)
Sales increase			0.38**	0.47***
			(0.18)	(0.18)
Investments			0.70***	0.39
			(0.23)	(0.26)
Constant	-3.47***	-3.72***	-3.92***	-4.41***
	(0.37)	(0.46)	(0.40)	(0.53)
Observation	599 (431)	599 (431)	599 (431)	599 (431)
R^2 (Cox and Snell)	0.29	0.34	0.31	0.35
R^2 (Nagelkerke)	0.33	0.39	0.35	0.40
R^2 (McFadden)	0.16	0.20	0.18	0.21
-2 Log likelihood	388.67	718.16	616.01	825.60
Chi square	200.64***	247.41***	221.71***	260.40***
Correctly classified	58.60%	59.30%	59.40%	61.10%

Note: * p<0.10; ** p<0.05; *** p<0.01.

Results of Table 4.3 point to substantial differences when comparing the outcomes of liquidation, marginal and successful survival. While marginal survivors were not significantly impacted by turnaround strategies, for successful ones both *retrenchment* and *recovery* strategies were decisive. Therefore, the effectiveness of turnaround strategies proved valid for successful turnarounds within the bankruptcy procedure, while mere survival (but unsuccessful turnaround) was determined by structural factors (*time*, *size* and *slack*) that allowed firms to overcome bankruptcy, although their performance did not improve at the end of the procedure. These results give support to the division of a turnaround outcome in more than two solutions, considering the nuances observed between them.

Table 4.4 presents the results for the multinomial logistic regression analyses comparing marginal survival (reference) with success. Again, Model 1 includes only the control variables, which showed consistent results in all the models. They also present the same explanatory power, chi square and accuracy

than those of Table 4.2, given that the underlying models are the same, but they compare different outcomes. The R^2 are also equivalent to those of Table 4.2.

Table 4.4. Results of the multinomial logistic regression – success vs marginal.

	Model 1	Model 2	Model 3	Model 4
Time	0.27*	0.29*	0.26*	0.28*
	(0.14)	(0.15)	(0.14)	(0.15)
Size	-0.35*	-0.29	-0.30	-0.24
	(0.18)	(0.19)	(0.19)	(0.19)
Industry	0.16	0.11	0.19	0.14
	(0.25)	(0.26)	(0.26)	(0.26)
Slack	0.22	0.06	0.21	0.06
	(0.25)	(0.26)	(0.26)	(0.27)
Prior performance	0.51	0.70**	0.49	0.74**
	(0.30)	(0.32)	(0.31)	(0.32)
Cost retrenchment		0.54***		0.63***
		(0.15)		(0.15)
Asset retrenchment		-0.56***		-0.40**
		(0.17)		(0.19)
Sales increase			0.30*	0.41**
			(0.17)	(0.18)
Investments			0.41*	0.25
			(0.23)	(0.27)
Constant	-0.43	-0.82*	-0.73	-1.36***
	(0.39)	(0.47)	(0.41)	(0.52)
Observation	599 (302)	599 (302)	599 (302)	599 (302)
R^2 (Cox and Snell)	0.29	0.34	0.31	0.35
R^2 (Nagelkerke)	0.33	0.39	0.35	0.40
R^2 (McFadden)	0.16	0.20	0.18	0.21
-2 Log likelihood	388.67	718.16	616.01	825.60
Chi square	200.64***	247.41***	221.71***	260.40***
Correctly classified	58.60%	59.30%	59.40%	61.10%

Note: * p<0.10; ** p<0.05; *** p<0.01.

In the models of Table 4.4 the only control variable that proved significant was *time* (0.27; p<0.10), except in Model 4, in which also *prior performance* had a positive impact on success (0.74; p<0.05). Model 2 also analyzed *retrenchment* actions, which presented the predicted relationship with successful turnarounds. *Cost retrenchment* contributed to survival and performance improvement (0.54; p<0.01), while *asset retrenchment* had the inverse sign (-0.56; p<0.01), thus it proved a damaging action for a successful turnaround. Regarding *recovery* strategies (Model 3), pursuing both *sales-increasing* actions (0.30; p<0.10) and *investments* (0.41; p<0.10) was positively associated to a successful turnaround. When evaluated in combination, turnaround strategies showed similar results to those comparing liquidating and successful firms. *Cost retrenchment* was significantly and positively related to success (0.63; p<0.01), while *asset cuttings* reduced the likelihood of surviving and improving performance during

bankruptcy (-0.40; p<0.05). Besides, *increasing sales* improved the probabilities of a successful turnaround (0.41; p<0.05). Nonetheless, *investments* lost again their significance in case that both retrenchment and recovery strategies were assessed.

In summary, attending to the aforementioned results, the proposed hypotheses received general substantial support when evaluating success, except for the one evaluating *investments*. The comparison between liquidation and marginal survival was determined mainly by structural factors and not by turnaround strategies. Hypothesis 1a (*cost retrenchment*) received a strong support, given that in all cases positively contributed to success. Hypothesis 1b (*asset retrenchment*) was supported as well, considering the negative impact shown in all the models along with its significance. Hypothesis 2a proved notably supported, given the positive association of *sales increase* with survival and performance improvement. Finally, Hypothesis 2b (*investments*) was partially supported, since only in models evaluating isolated *recovery* strategies presented the variable the predicted significant positive sign. This poses some doubts on the validity of aggressive recovery strategies during bankruptcy, probably limited by the scarcity of resources suffered by firms.

4.1.2. The moderating effect of the competitive environment (Test II).

To evaluate the predicted moderating effect of the competitive environment, a multinomial logistic regression (Test II) was conducted in order to assess the effects of the independent variables on the three possible outcomes of the procedure also taking into account the environment in which the bankrupt firms operated: munificent or stagnating and declining. Results are reported in the three following tables (4.5 through 4.7), one of which compared two outcomes and two environments.

To display the results of the multinomial logistic regression, four models were defined in the subsequent tables. Model 1 includes the prediction results only using control variables in a munificent environment, while Model 3 has solely control variables for a declining environment. Models 2 and 4 address the effects of independent variables. The estimated coefficient (β_i), its significance

(*) and the standard error (S.E.) were calculated, in order to interpret the magnitude of the relationship between each independent and control variables with the dependent one. It must be highlighted that both control (Models 1 and 3) and complete (Models 2 and 4) models present higher accuracy and explanatory power than those evaluated in the prior subsection. Consequently, disaggregating environments proved to incorporate valuable nuances to the analyses undertook in this research.

In Table 4.5 the results of the moderating effect of competitive environment between marginal survivors and liquidated firms are reported. Regarding control variables, *time*, *size* and *slack* were found to positively impact survival in both competitive settings. Conversely, *prior performance*, as in the previous test, had a negative effect in survival. *Industry* was only significant when studying munificent environments, and showed a positive sign, thus belonging to a manufacturing industry improved the likelihood of marginal survival within munificent industries.

On the other side, turnaround actions were somehow moderated by the competitive environment. *Cost retrenchment* showed a negative but non-significant sign in munificent industries, while it was positive and also non-significant in stagnating/declining settings. Similarly, *asset retrenchment* had a negative impact in both industries, but its effect was not significant. While *retrenchment* actions did not have any substantial effect on the compared outcomes, *recovery* measures differed between environments. Marginal survival in munificent environments was positively associated with both *sales increase* (0.41; $p<0.10$) and *investments* (0.34; $p<0.10$). In contrast, firms in stagnating and declining industries were positively affected by *sales increase* (0.22; $p<0.10$) but negatively by *investments* (-0.40; $p<0.10$), as predicted. Therefore, moderation in turnaround strategies was observed in *recovery* actions when comparing the outcomes of liquidation and marginal survival, while no significant effects were observed for *retrenchment*. This gives partial support to the proposed moderation effect on turnaround strategies and provides some explanation to the irrelevant effects observed in the prior subsection, given the contradicting results obtained for *recovery* strategies.

Table 4.5. Results of marginal vs liquidation controlling for environment.

	Munificent		Stagnating and declining	
	Model 1	**Model 2**	**Model 3**	**Model 4**
Time	0.66***	0.69***	0.74***	0.75***
	(0.20)	(0.21)	(0.16)	(0.17)
Size	0.96***	1.04***	0.45*	0.51*
	(0.28)	(0.28)	(0.26)	(0.26)
Industry	0.73**	0.69**	0.00	0.08
	(0.34)	(0.35)	(0.33)	(0.33)
Slack	1.14***	1.08***	1.43***	1.37***
	(0.34)	(0.35)	(0.31)	(0.32)
Prior performance	-0.88*	-0.88*	-0.69*	-0.63*
	(0.49)	(0.51)	(0.36)	(0.37)
Cost retrenchment		-0.08		0.21
		(0.19)		(0.17)
Asset retrenchment		-0.26		-0.14
		(0.26)		(0.21)
Sales increase		0.41*		0.22*
		(0.31)		(0.24)
Investments		0.34*		-0.40*
		(0.49)		(0.32)
Constant	-3.58***	-3.43***	-2.62***	-2.85***
	(0.50)	(0.70)	(0.42)	(0.56)
Observation	291 (210)	291 (210)	308 (255)	308 (255)
R^2 (Cox and Snell)	0.31	0.43	0.29	0.33
R^2 (Nagelkerke)	0.35	0.49	0.33	0.38
R^2 (McFadden)	0.17	0.26	0.17	0.20
-2 Log likelihood	245.64	392.81	263.40	468.06
Chi square	106.72***	162.26***	104.23***	122.00***
Correctly classified	58.40%	67.20%	60.10%	66.40%

Note: * p<0.10; ** p<0.05; *** p<0.01.

Regarding successful turnarounds, Table 4.6 reports the results comparing successful turnarounds and liquidations. The only control variables that proved significant and consistent among analyses were *time* and *slack*. In contrast, *size* was only significant in munificent environments while irrelevant in stagnating/declining ones. *Industry* and *prior performance* were non-significant when distinguishing success from marginal survival in both competitive settings.

On one hand, turnaround strategies showed the predicted moderation by the competitive context. *Cost retrenchment* contributed to successful turnarounds in both munificent (0.71; p<0.01) and stagnating/declining industries (0.74; p<0.01), as hypothesized. Conversely, while *asset retrenchment* had a detrimental effect in munificent environment (-1.01; p<0.01), it presented a positive impact in stagnating/declining industries (0.23; p<0.10). On the other side, *sales increase* improved the likelihood of success in both environments

(0.62; p<0.05 and 0.38; p<0.10 in munificent and stagnating/declining industries respectively). Finally, *investments* showed the expected positive sign in munificent environments, but it proved non-significant. In contrast, it impacted negatively in stagnating and declining environments (-0.30; p<0.10), as predicted. Therefore, these results give substantial support to the proposed hypotheses, since some moderation was observed in *investments* and total moderation in *asset retrenchment*, while *cost retrenchment* and *sales increase* remained unchanged as proposed.

Table 4.6. Results of success vs liquidation controlling for environment.

	Munificent		**Stagnating and declining**	
	Model 1	**Model 2**	**Model 3**	**Model 4**
Time	0.95***	1.03***	1.06***	1.05***
	(0.20)	(0.23)	(0.20)	(0.21)
Size	0.58**	0.78***	-0.10	-0.03
	(0.28)	(0.30)	(0.31)	(0.33)
Industry	0.51	0.39	0.51	0.60
	(0.33)	(0.37)	(0.40)	(0.41)
Slack	1.27***	1.08***	1.92***	1.62***
	(0.34)	(0.37)	(0.39)	(0.41)
Prior performance	0.23	0.49	-0.65	-0.40
	(0.39)	(0.47)	(0.43)	(0.45)
Cost retrenchment		0.71***		0.74***
		(0.22)		(0.23)
Asset retrenchment		-1.01***		0.23*
		(0.29)		(0.26)
Sales increase		0.62**		0.38*
		(0.28)		(0.27)
Investments		0.36		-0.30*
		(0.39)		(0.39)
Constant	-3.56***	-4.25***	-3.45***	-4.48***
	(0.53)	(0.78)	(0.56)	(0.76)
Observation	291 (216)	291 (216)	308 (215)	308 (215)
R^2 (Cox and Snell)	0.31	0.43	0.29	0.33
R^2 (Nagelkerke)	0.35	0.49	0.33	0.38
R^2 (McFadden)	0.17	0.26	0.17	0.20
-2 Log likelihood	245.64	392.81	263.40	468.06
Chi square	106.72***	162.26***	104.23***	122.00***
Correctly classified	58.40%	67.20%	60.10%	66.40%

Note: * p<0.10; ** p<0.05; *** p<0.01.

Finally, the results of the two survival outcomes (marginal and successful) are deployed in Table 4.7. None of the control variables proved significant across all the models. Instead, *size* was significantly and negatively related to success in stagnating and declining industries, while *prior performance* presented a significant and positive sign in growing environments.

Turnaround strategies were also moderated by the competitive environment as expected. Firstly, *cost-cutting* measures were positively associated to success in both munificent (0.79; p<0.01) and stagnating/declining industries (0.53; p<0.05). In contrast, *asset retrenchment* presented a negative sign in munificent environments (-0.75; p<0.05) which turned into positive when evaluating stagnating and declining settings (0.09; p<0.10). *Increasing sales* contributed to improve the likelihood of success in growing (0.21; p<0.10) and stagnating/declining environments (0.59; p<0.05). Finally, while *investments* were positively related with success in munificent environments, the variable proved non-significant. Conversely, *investments* in declining and stagnating industries had a negative impact on success (-0.10; p<0.10). All in all, the moderation effect of environment was also shown when comparing survival outcomes and presented the expected changing signs (*asset retrenchment* and *acquisitions*) or stability (*cost retrenchment* and *sales increase*).

Table 4.7. Results of success vs marginal controlling for environment.

	Munificent		**Stagnating and declining**	
	Model 1	**Model 2**	**Model 3**	**Model 4**
Time	0.30 (0.21)	0.34 (0.23)	0.32 (0.20)	0.31 (0.21)
Size	-0.37 (0,25)	-0.26 (0.27)	-0.55* (0.29)	-0.53* (0.30)
Industry	-0.22 (0.35)	-0.30 (0.38)	0.51 (0.40)	0.53 (0.41)
Slack	0.13 (0.36)	-0.01 (0.38)	0.49 (0.39)	0.25 (0.40)
Prior performance	1.11** (0.48)	1.38** (0.54)	0.04 (0.44)	0.23 (0.45)
Cost retrenchment		0.79*** (0.22)		0.53** (0.23)
Asset retrenchment		-0.75** (0.30)		0.09* (0.26)
Sales increase		0.21* (0.27)		0.59** (0.27)
Investments		0.70 (0.46)		-0.10* (0.39)
Constant	0.10 (0.58)	-0.28 (0.73)	-0.84 (0.56)	-1.22* (0.67)
Observation	291 (156)	291 (156)	308 (146)	308 (146)
R^2 (Cox and Snell)	0.31	0.43	0.29	0.33
R^2 (Nagelkerke)	0.35	0.49	0.33	0.38
R^2 (McFadden)	0.17	0.26	0.17	0.20
-2 Log likelihood	245.64	392.81	263.40	468.06
Chi square	106.72***	162.26***	104.23***	122.00***
Correctly classified	58.40%	67.20%	60.10%	66.40%

Note: * p<0.10; ** p<0.05; *** p<0.01.

In summary, it can be stated that the proposed hypotheses received stronger support when comparing success with liquidation and marginal survival than comparing marginal survivors with liquidated firms. Specifically, Hypothesis 1 (*retrenchment*) was validated in determining the success of the bankruptcy procedure, but not when marginal survival and liquidation outcomes were compared. Hypothesis 1a (*cost retrenchment*) was strongly supported in the models which compared success with liquidation or marginal survival. Also Hypothesis 1b (*asset retrenchment*) received similar strong support. Hypothesis 2 (*recovery*) proved valid across successful scenarios, while it was irrelevant distinguishing between marginal survival and liquidation. Hypothesis 2a (*sales increase*) was supported when success was evaluated as well. In contrast, Hypothesis 2b (*investments*) was only partially supported when successful and liquidated firms were compared, while it remained irrelevant in the rest of scenarios.

On the other hand, the impact of competitive environment (Hypothesis 3) proved to be relevant in the effectiveness of turnaround strategies. While some moderation was shown between recovery actions comparing marginal survival and liquidation, clearer results were reported when studying successful outcomes with the other two. Particularly, Hypothesis 3a (*cost retrenchment*) predicted that environment was irrelevant for its effectiveness, which was confirmed in all models except when comparing marginal survivors and liquidated firms. Similarly, Hypothesis 3b (*asset retrenchment*) was validated when evaluating success with the other two outcomes, since *asset retrenchment* signs were positive in stagnating and declining industries, while negative in munificent ones. Hypothesis 3c (*sales increase*) was validated across all the results, showing that it had a positive impact regardless of the competitive environment. Finally, Hypothesis 3d (*investments*) was partially validated, since despite its expected positive sign in munificent industries, it resulted non-significant. Conversely, it proved to have detrimental effects on success when it was implemented in stagnating and declining industries.

Control variables showed similar results as well, being significant and with the expected signs comparing marginal survival and success with liquidation,

but not between survival outcomes. Particularly, it can be stated that *time*, *size*, *industry* and *slack* are positively related and relevant for surviving a bankruptcy procedure. *Prior performance* has shown varied results, as found by Ndofor et al. (2013). However, what determines success is the set of actions undertook by bankrupt firms, which must consider the environment in which operate. A summary of the results is depicted in Table 4.8.

Table 4.8. Summary of results.

Hypothesis	Test		
	Marginal vs liquidation	**Success vs liquidation**	**Success vs marginal**
H1: Retrenchment	Not validated	Validated	Validated
H1a: Cost retrenchment	Not validated	Validated	Validated
H1b: Asset retrenchment	Not validated	Validated	Validated
H2: Recovery	Not validated	Validated	Validated
H2a: Sales increase	Not validated	Validated	Validated
H2b: Investments	Not validated	Partially validated	Not validated
H3: Competitive environment moderation	Partially validated	Validated	Validated
H3a: Cost retrenchment / environment	Not validated	Validated	Validated
H3b: Asset retrenchment / environment	Not validated	Validated	Validated
H3c: Sales increase / environment	Validated	Validated	Validated
H3d: Investments / environment	Partially validated	Partially validated	Partially validated

Source: Own elaboration.

In conclusion, the empirical results broadly supported the proposed hypotheses. Adopting *cost retrenchment* and *sales increasing* actions improved the likelihood of surviving a bankruptcy procedure *and* improving performance. Nonetheless, *asset retrenchment* is not a prescribed action within bankruptcy,

since it damaged the resource base of the firm and had detrimental effects for survival and subsequent performance. This fact, however, is moderated by the competitive environment and it may explain why some bankrupt firms achieve survival despite selling assets. The reason is that they operate in declining industries, in which retrenchment due to overcapacity may have a positive effect in survival and performance improvement. Finally, *investing* might be a beneficial turnaround strategy depending on the environment on which the firm operates. While in declining industries investing is not a recommended recipe, munificent industries may offer acquisition opportunities that may contribute to survival and performance turnaround. However, resource scarcity may pose significant limitation to such strategy.

From the structural point of view, it was confirmed that larger firms have greater probabilities to emerge from bankruptcy than smaller ones, but the interesting nuance was that *size* did not matter when comparing successful firms with marginal ones. Even in some scenarios, size was detrimental for successful turnarounds, perhaps due to some rigidities and restrictions regarding turnaround strategies implementation. Also, in some cases, spending a longer *time* in the procedure was beneficial for success, probably due to the automatic stay period. Also having certain financial *slack* proved to contribute to a successful outcome when comparing survivors and liquidated firms, as previous literature suggested.

Finally, *manufacturing* firms yielded higher probabilities of survival than *services and trading*, while it was not decisive for success. *Prior performance* showed contradicting results. While it had a negative association when distinguishing marginal survivors and liquidated firms, it proved beneficial confronting successful and marginal turnarounds. This might suggest that liquidated firms had a better performance than marginal survivors but were not able to reverse their troubles. Conversely, firms that successfully turned around, had a higher base performance and were able to properly act to restore prior profitability. Again, prior literature findings were confirmed regarding higher survival likelihood of manufacturing firms within a bankruptcy procedure, which may point out that such firms yield a greater value for stakeholders to preserve them despite their financial and economic difficulties.

4.2. Discussions.

4.2.1. The unequal effectiveness of retrenchment strategies in high severity situations.

The empirical analysis of the first hypothesis showed the association of the two proposed retrenchment strategies (cost and asset retrenchment) with the probability to succeed a bankruptcy procedure. The results point out that traditional stabilization measures – retrenchment – are not universally valid to increase the success likelihood during bankruptcy. Particularly, cost retrenchment proved to positively contribute to successful turnarounds, while reducing assets had a negative effect in the probability of improving performance. Curiously, none of the retrenchment actions had effect when studying marginal survivors and liquidated firms. These findings suggest that not all retrenchment actions are equally effective in contributing to firm survival. Prior turnaround scholars have generally assumed homogeneous results when addressing retrenchment in high severity crises. However, in this research a different approach to the study of retrenchment and turnaround in SMEs was taken, proposing the existence of contradicting effects when adopting different retrenchment measures. Therefore, scholars cannot study retrenchment as a uniform and homogeneous turnaround strategy, but they should disaggregate it in order to unveil the consequences that it may have for the firm.

These contradicting effects make retrenchment a strategic action of first magnitude. Traditionally, retrenchment has been studied as a generic action adopted for cash-raising, regardless of the measures taken. There has not been a concern on "what" and "how" to retrench when a firm faces decline. Nonetheless, these findings propose to differentiate retrenchment actions, specifically in the most severe distress context (bankruptcy). Retrenchment should be taken carefully and must be a programmed action that provides stabilization and increases the probability to survive. While general costs reductions improve the firm's survival expectations, as proposed by prior turnaround scholars (Hambrick and Schecter, 1983; Hofer, 1980; Robbins and Pearce, 1992), asset reductions produce the contrary effect. This may lay in the specificities of firm's assets. It must be stated that both surviving and liquidating

firms adopt retrenchment strategies in assets. However, surviving firms implement them in a "moderate" manner. This finding suggests the existence of a threshold upon which retrenchment, despite being necessary for survival, reduces the probability to survive. Accordingly, the "level" of retrenchment seems to be an additional aspect that should be addressed when analyzing turnarounds.

Additionally, reducing operational costs does not directly impact the firm's capabilities (Filatotchev and Toms, 2006), while selling assets does. Its effects in prior turnaround studies are contradictory, so these results add to such debate, but in a context of high severity decline, where they should be expected to be beneficial for the firm's performance. Selling assets has been associated to extremely severe declines (Hambrick and Schecter, 1983; Hofer, 1980; Robbins and Pearce, 1992), but the predicted turnaround outcome varies from industries and cultural environments (Bruton et al., 2003; Lim et al., 2013; Morrow et al., 2004). Despite bankrupt firms suffer a severe crisis, asset retrenchment seems to have a limited impact in the probability to survive the procedure. It must be noted that both surviving and liquidating firms reduce their assets. Besides, secured creditors may have selfish behaviors and try to capture their collaterals (typically fixed assets) in order to get their debts paid, leaving bankrupt firms without those assets. If debts have been guaranteed with non-productive assets (e.g. investments in real estate, not related to productive activity), their realization may even contribute to debt reduction and increase productivity. However, in case that key productive assets had been given as collaterals, the firm should protect them to increase their probability to survive bankruptcy. Conversely, if the firm sells them or it is dispossessed by secured creditors, the survival likelihood reduces, as found in this research.

Nonetheless, some moderating effect was observed in stagnating and declining industries, in which some room for asset disposal was validated. Despite this sort of concession, assets disposals are not positively related with performance improvements during bankruptcy, thus suggesting that such disposals must be carefully managed. If not done properly, asset retrenchment will reduce survival and turnaround likelihood.

In summary, reducing operational costs is a prescribed recipe to survive and improve performance during bankruptcy, while asset reductions must be carefully considered, given their damaging effects in the resource base of bankrupt firms. Some possibilities of asset disposals exist when the firm operates in a declining industry, in which overcapacity problems may force to asset sells in order to raise the necessary cash to keep the business running.

4.2.2. The implementation of recovery strategies.

Despite the substantial limitations of a bankruptcy procedure, there is some room for the adoption of recovery strategies. The empirical validation of the second hypothesis showed that, specifically, sales-increasing measures had a positive contribution to performance improvements, while acquisitions needed careful scrutiny, given that not strong statistical relationships were found between them and success within bankruptcy.

On one hand, pursuing sales increasing strategies is a natural way of increasing profitability if the firm operates with a substantial margin. Further product units sold will notably improve firm's performance, despite its economic condition. Nonetheless, bankrupt firms must cope with difficulties related to sinking reputation, damaged marketing image and scarce resources to increase sales. Since the rationale of this research assumed that sales-increasing measures could only be adopted once retrenchment strategies were adopted, the beneficial interactions between them have also aroused in the analyses. Once cost retrenchment actions were implemented, sales-increasing efforts could be directed given the positive effect that cost retrenchment proved to produce on survival and subsequent performance (Bruton et al., 2003; Morrow et al., 2007). Cost retrenchment allowed for the reallocation of resources, which could be devoted to marketing efforts, increasing customer base or providing better sales conditions, in order to increase firm's revenues. As such, revenues growth was positively related with survival and turnaround in all the models in which success was included. This also points out to the effects of the automatic stay for the firm's reputation. As proposed by Kahl (2002), bankruptcy is *de facto* a liquidating process unless the firm is able to restore stakeholders' belief that the firm's value as a going concern is greater than being liquidated. Consequently,

if the firm is able to restore relationships with stakeholders and recover their support, its reputation will also improve and thus the market will recognize its efforts.

Results when studying investments were not as clear as for sales-increasing measures. Investing might be a difficult-to-implement recovery action during bankruptcy. A bankrupt firm has limited resources and limited access to additional financing, thus investing in new assets or businesses was rarely observed. Empirical analyses provided some support to the positive contribution of investments to survival and turnaround, but its effects proved non-significant when combined with the rest of turnaround strategies. This reinforces the idea that sales increases must be pursued without substantial asset acquisitions. However, if a bankrupt firm was able to undertake substantial investments, it meant that it raised enough financial funds to invest, which is a clear signal of stakeholders' support and credibility of the firm's viability plan. Therefore, despite it might be rarely observed, acquisitions might surely point out that the firm is able to emerge from bankruptcy and turn its performance around. An additional explanation for this fact could be given by the moderating role of competitive environment. A moderating effect was predicted and observed in acquisitions, which had a negative impact when the bankrupt firm operated in declining industries and it was positive in munificent industries. Given that bankrupt firms can rarely take substantial investment risks given the control imposed by creditors and the court, only fairly profitability investments would be allowed by stakeholders, who want their debts to be repaid.

In conclusion, recovery strategies did not broadky convey positive results for survival and successful turnarounds. Although increasing sales was clearly associated to improving performance, attending to the interactions of prior cost retrenchment strategies, investments should be object of watchful study, given that no clear empirical validation was provided to the effects of turnaround. The focus of bankrupt firms in cash-raising and resource scarcity are substantial limitations for additional investments, unless the firm has regained stakeholders' support, which could provide enough funds to invest in profitable opportunities, particularly in munificent industries.

4.2.3. The moderating role of the competitive environment.

The third hypothesis suggested that competitive environment somehow impacted the effectiveness of turnaround strategies, and empirical results gave substantial support to it. Prior literature clearly stated that environment should be taken into consideration when studying turnaround strategies (Barker and Duhaime, 1997; Morrow et al., 2004; Ndofor et al., 2013), since it shaped the effectiveness of turnaround measures. Competitive environment is also a proxy for the cause of decline, a relevant contingency factor in BT studies. A declining firm operating in a munificent industry may be suffering primarily from internal struggles and poor strategic positioning, thus strategic actions are expected to positively contribute to its performance turnaround. Conversely, declining firms in stagnating or declining industries may suffer mainly from external causes of decline (but also internal), which would require efficiency-oriented strategies to restore prior performance.

The empirical validation shared prior literature findings, showing that its impact was relevant in asset retrenchment measures and acquisitions, but there were no effects on cost retrenchment and sales-increasing actions. Cost retrenchment were found effective across settings, thus confirming the general assertion of Robbins and Pearce (1992) regarding the universal validity of cost-cutting strategies. Also, revenue growth strategies were significantly related to successful turnarounds regardless of the industry. Sales increasing measures, although adopted in declining industries, proved beneficial for bankrupt firms, given that their impact was assessed after having adopted cost reductions, and thus economic viability was probably restored.

Environment mainly had influence in asset disposals and acquisitions. Munificent industries showed investment opportunities, which had the expected positive effect on firm's turnaround, but also proved that asset disposals were harmful for survival and success. Selling assets in a growing environment might be detrimental because of the increasing value of such assets. If the firm sells such valuable assets it may lose a valuable resource base that would be difficultly restored with the raised cash. In contrast, stagnating and declining environments presented the contrary results. Investment opportunities are scarce and perhaps

expensive in declining industries, thus a negative effect was observed for investments. Asset disposals in such environments positively contributed to survival and success, given that the cash provided by disposals could be reinvested in keeping the business running or repaying debts, and not necessarily in additional plant and equipment, given the overcapacity problem that declining industries often suffer. Consequently, bankrupt firms must consider their environment prior to take any action regarding asset disposals or investments, given the decisive influence that economic setting have on such turnaround actions.

4.2.4. Successful turnarounds within the bankruptcy procedure.

Bankrupt firms' turnaround was studied in two ways. Firstly, assessing the probability of surviving and increasing performance during the procedure, and secondly evaluating the moderating effect of the competitive environment on turnaround strategies. The results revealed that surviving firms rely on deep cost retrenchment actions and preferably preserved assets. Also, sales-increasing strategies improved the likelihood of turnaround. A longer time in the procedure, a larger size, higher financial slack and developing manufacturing activities led to higher survival rates as well. Nonetheless, these structural factors did not impact of subsequent performance improvement, which relied exclusively on the turnaround actions taken by bankrupt firms. These findings add to BT literature, in the sense that some of the assumed principles, particularly relating the universal validity of retrenchment, were challenged when assessed in bankrupt firms.

Bankruptcy has been often considered as a synonymous of "failure" in the turnaround literature. Besides, scholars from the strategy field who have approached the bankruptcy context have highlighted its pernicious effects and the stigma suffered by firms entering the procedure (Moulton and Thomas, 1993; Sheppard, 1994; Sheppard and Chowdhury, 2005; Sutton and Callaghan, 1987; Xia et al., 2016). Without confronting such negative aspects of bankruptcy, which have been explicitly acknowledged throughout the dissertation, the intention of this research was to evaluate what should firms do to overcome bankruptcy. Although the advice to a firm in distress would be for it to avoid the

procedure, but not at any cost, it is also certain that once entered in the procedure it offers some tools and mechanisms that allow survival and even improving performance.

Obviously, the conditions with which the firm enters bankruptcy matter. Being a medium or large firm is useful to face the high costs of the procedure (Altman and Hotchkiss, 2006; Thorburn, 2000) and belonging to a manufacturing industry also delivers higher survival likelihood (Camacho-Miñano et al., 2015). Also, financial slack proved to increase the success likelihood. However, the empirical results showed interesting nuances, particularly when the competitive environment was considered. The economic context substantially affected the effectiveness of turnaround strategies concerned with asset disposals and acquisitions. While munificent industries provided greater investment opportunities, asset reductions were detrimental for survival and performance. In contrast, stagnating and declining industries did not provide interesting investment chances, while allowing for some asset retrenchment. This relates to the firm's value during bankruptcy, in order to convince creditors that the firm as a going concern will produce a higher debt repayment capacity. In that aim, intense cost retrenchment proved significantly associated with success. Reduced costs, without altering productive capacity and increasing revenues, mean higher cash flows and, as a result, a higher firm value. Also, taking advantage of some investment opportunities could provide greater probabilities of success.

The general principles of retrenchment, as shown by the results, cannot be applied to asset disposals. The harmful effects that such actions produce on bankrupt firms suggest to carefully study their adoption. Despite that it is an intuitive efficiency-increasing strategy, their collateral effects impact performance and expectations in such a way that survival and success probabilities reduce when firms implement them. Asset retrenchment had negative effects on survival and subsequent performance increases during bankruptcy. Bankrupt firms often reach the procedure in a critical situation, after attempting inadequate measures that lead them to insolvency. As a result, their assets are usually very limited to those of their core business which, if sold, they

lose their principal mean of productive capacity. Empirical results convey that assets should be preserved and used as a base for future recovery, given that intense disposals deprive the firm from one of its most valuable resources.

When a bankrupt firm is forced to sell assets, it is usually due to the need to obtain cash or the need for the secured creditors to get their debts repaid. In both situations, the intervention of the bankruptcy administrator and the Court is required, which normally find in favor of such disposals, despite the obvious value destruction for the firm. The guiding principle of the Spanish bankruptcy law is that creditors shall be paid, thus viability is put in a second level. These findings challenge such principle and contend that the main objective of the bankruptcy law should be the firm's survival, if the firm is economically viable, given that higher satisfaction is given to creditors and the society as a whole.

Nonetheless, some aspects of the BT process remained unstudied in this research. Despite the competitive environment was entered into the analyses, the explicit cause of decline was not considered (Robbins and Pearce, 1992). Also, the declining rate prior to bankruptcy was not studied, despite it could add some relevant ideas to the analyses. The intrinsic declining source, either economic or financial, was not evaluated neither (Cook et al., 2011). Bankrupt firms could face the procedure suffering either one of both types of distress, and probably strategies adopted during the procedure are conditioned by such sources (Naujoks, 2012).

All in all, managing a bankrupt firm implies challenging some of the assumed principles of a turnaround, given that not all the traditional recipes are valid. The firm should get rid of those superfluous expenses that do not add value to their production (cost retrenchment) but at the same time it must preserve valuable assets. Also firms pursuing sales-increasing strategies will benefit from a higher survival likelihood and performance. Investments need to be carefully managed, given that differing effects across industries have a decisive impact in subsequent firm's performance. In conclusion, the procedure poses significant limitations to implement such measures, which bankrupt firms must overcome.

4.2.5. Implications for scholars, legislators and managers.

Several implications for scholars, legislators and bankrupt firms' managers can be drawn from this research. For turnaround scholars, further research is required on the relationship between turnaround context, content, process and timing of turnaround strategies. Another insight here is that not all retrenchment actions are equally effective when facing decline and, in this research, surviving a bankruptcy procedure. This study suggests that cost retrenchment helps to improve the likelihood of a successful turnaround, whereas asset retrenchment does not. Accordingly, the disaggregation in these or further retrenchment areas needs to be taken into account by scholars. In relation to recovery, bankrupt firms should pursue sales-increasing strategies after adopting retrenchment measures, while acquisitions should be carefully considered.

Legislators can be also enriched with the implications of this research. The most important one is to design bankruptcy procedures that allow a careful scrutiny of retrenchment strategies. Asset retrenchment should not be encouraged not blindly authorized as the only way to stabilize a bankrupt firm. Bankruptcy administrators in particular should be experienced experts that are able to judge the appropriateness of proposed actions on a case-by-case basis. Certain actions should be moderated such as retrenchment in assets, since excessive reduction can lead to a resource depletion that will undermine survival likelihood. Also, legislation that limits the power of secured creditors such as banks is implied as powerful, and over-zealous and narrow-minded secured creditors may force deeper than necessary retrenchment. These policy recommendations could address the low success rate of firms within bankruptcy procedures. For example, Hotchkiss (1995) reports that over 40% of firms within the US Chapter 11 procedure experience operating losses in the subsequent three years and Moulton and Thomas (1993) report a 10% success rate.

Finally, managers of bankrupt firms should focus on operative improvements, which allow further recovery strategies which in turn gives creditors a better alternative for their claim repayment through survival than liquidation. Managers also need to be careful not to sell assets or over-invest in the face of financial crisis. Such irrational behaviour may be explained by

prospect theory (Kahneman and Tversky, 1979): if losses are irrationally over-valued, then corrections will be over zealous, possibly twice as much as rationally necessary (Thaler, 2015). The findings suggest that reducing assets has a negative impact in the likelihood of survival, except when adopted in stagnating or declining industries. Besides, investments yielded contradictory results when comparing environments, since growing industries seemed to provide better opportunities. Accordingly, managers are urged to carefully examine the use of asset-related turnaround strategies in a bankruptcy procedure.

4.3. Conclusions.

In this chapter the empirical results and discussions of the findings were presented. The observed evidences generally support the expected impacts of retrenchment and recovery responses in the success or failure of bankrupt firms attempting turnaround. Also, the competitive environment showed a moderating effect in asset-related turnaround strategies. On one hand, retrenchment responses showed the expected unequal influence in the turnaround outcome. While intense cost retrenchment was undoubtedly a beneficial measure to survive and obtain performance gains, asset retrenchment had, in general, detrimental effects on both outcomes. Only stagnating or declining industries allowed for asset retrenchment, given the overcapacity problem that may underlie in those environments. Regarding recovery measures, pursuing sales-increase proved positively associated in all industries, while investments conveyed contradictory results when considering the competitive environment. In stagnating and declining industries, turnarounds had a clear negative association with investments, while there was no a significant relationship in growing industries.

The findings suggest that 1) cost-cutting measures are prescribed as appropriate retrenchment actions, while assets should be preserved as far as possible; 2) recovery strategies pursuing sales growth after adopting retrenchment are recommended as effective turnaround strategies, while investments should be carefully considered; 3) the competitive environment has an impact on investment and divestment strategies of the firm, while not in cost retrenchment and sales-increase strategies; 4) while time, size, slack and industry are relevant for survival, successful turnarounds in a bankruptcy procedure rely on the firm's actions and not in structural factors; and 5) further study is required to unveil the dynamics of the turnaround process in such a severe crisis context as bankruptcy.

Chapter 5. Conclusions, limitations and future research streams

5.1. Conclusions.

The economic and financial struggles caused by the Great Recession in a large number of firms around the world has renewed the interest on BT. Despite that turnaround literature embraces a period of more than 40 years since its beginnings, little attention had been paid to how bankrupt firms could attempt a turnaround and achieve survival. In the light of the 2008 global crisis, the profound changes in bankruptcy regimes worldwide, following the principles of the US Chapter 11, provided a wider range of tools for bankrupt firms to survive. Why would it be more convenient to save an ailing firm than leaving it die and creating a new one? International institutions and academicians point out that firms that are able to survive a crisis become more resilient, an ability that will help them in future recessionary periods. Also, to preserve valuable assets is worthier than destroy them and rebuild them again, which would take much more effort, money and time. In that purpose, effective bankruptcy procedures should discriminate viable firms from non-viable. The procedure should allow viable firms to survive and non-viable ones to be liquidated and their invested capital reallocated in profitable projects. Despite several advances in this sense, the Spanish bankruptcy procedure has still a long way to go.

The aim of this research was to shed light on the reasons of survival and success of Spanish bankrupt firms, as well as to orientate legislators, academicians and practitioners to face severe survival-threatening situations in the future. Specifically, it was intended to give answer to the issues that direct the research: Are cost and asset retrenchment strategies effective in increasing the turnaround likelihood? Are recovery strategies suitable for bankrupt firms? Does the competitive environment shape the effectiveness of turnaround strategies during bankruptcy? Previous turnaround studies have shown that retrenchment responses are unequal depending on the content of the actions taken. Also, that recovery strategies were not homogeneous across troubled firms. Finally, prior scholars have pointed out that the competitive environment was a relevant contingency for the effectiveness of turnaround actions and outcomes their outcomes. The bankruptcy and turnaround frameworks were overlapped by combining the two main outcomes of bankruptcy (liquidation or

survival) with those of the turnaround (failed turnaround or successful turnaround), from which the proposed outcomes of this study were extracted: liquidation, marginal survival and successful survival.

To such aim, a sample of 599 Spanish bankrupt firms were observed during the procedure until an outcome was reached. The implemented retrenchment responses and recovery strategies were evaluated. Also, the research incorporated the moderating effect of the competitive environment, which was observed in several turnaround studies.

The sample characteristics along with the longitudinal analysis within the theoretical framework applied gave solid sustain to several lessons, which can be taken into account to face survival-threatening situations in Spain. It is well acknowledged that closing a business involves painful consequences (such as job losses) and starting a new one has heavy costs that cannot be assumed easily. For that reason, policymakers have advocated in recent years for "second chance" regulations, with the aim to reduce firm mortality. It is on that principle on which the propositions of this research are made. In such stream, the conclusions drawn from the empirical analysis stand up for the continuity of existing businesses. Additionally, those conclusions have an added value: they come from resilient firms. As exposed in the presented analyses, such resilience derives from facing and overcoming situations of high severity and a low efficient bankruptcy procedure, the Spanish one.

Specifically, the obtained results show that responses to decline matter, but they are not equally effective regarding its content and conditions. Evidences reveal that careful scrutiny is key when implementing retrenchment responses. Such scrutiny rests on two pillars: 1) an effective and deep cost reduction and 2) a moderate or none asset reduction. Asset retrenchment measures become particularly relevant in the process, since their indiscriminate implementation leads to failure. Additionally, recovery responses relied on: 1) sales-increasing strategies after having adopted retrenchment and, in some conditions and 2) undertaking additional investments depending on the competitive environment. The environment proved to impact both asset retrenchment and investments, in the sense that contrary strategies are proposed under munificent and

stagnating/declining industries. While munificent industries present investment opportunities, asset retrenchment is not prescribed. Conversely, declining industries show a positive association between asset retrenchment and success, while investment actions reduced the likelihood of overcoming bankruptcy.

In summary, it can be stated that successful turnarounds during bankruptcy were achieved when firms implemented the correct retrenchment and recovery measures and also preserved their more valuable assets, while taking advantage of the competitive environment in which their activity was developed. This involves that, with independence from size, industry or severity of decline, a successful turnaround rests on the adequacy of the actions taken by the firm, not by the effect of other conjunctural factors or other elements non-controllable by the firm managers.

5.2. Research implications and contributions.

This research provides relevant contributions and implications for academicians, legislators and practitioners. In first place, this study contributes by linking bankruptcy and survival through BT literature. It also shows that the chosen theoretical framework its suitable to investigate such problem. In fact, the answer to what reasons motivate such a low survival rates in the Spanish bankruptcy procedure could be addressed from the turnaround framework in terms content, intensity and environmental adequacy. Particularly, this research advocates for implementing the adequate retrenchment measures, focusing in costs, in order to stabilize decline, while preserving the most valuable assets. Besides, pursuing an increase of sales, after having adopted retrenchment actions, and profitable investments, if evaluated carefully, further increase the likelihood of success. However, without an appropriate acknowledgement of the crisis, willing to act and quick and decided response it becomes impossible to turn a bankrupt firm around.

The findings also provide legislators with new clues to regulate bankruptcy regimes in order to increase their efficiency through firm survival. This research has drawn profiles of liquidated firms, those which survive marginally and those which success. The differences between them were several. Along with the quick response, determined cost-cutting and sales-increase, legislators should pursue that bankrupt firms raise enough cash and preserve their most valuable assets. Despite the traditional principle in the BT literature that retrenchment should be adopted in its most varied ways, reducing assets in excess turns to be detrimental for the firm's survival, since the immediate benefits that they may provide do not overcome the drawbacks. Also, the key role of stakeholders should not be neglected, since it may change the evolution of the firm and its probabilities to survive and improve its performance. Stakeholders become a critical party particularly for investment decisions, which should be prudently measured during bankruptcy.

At the firm's management level, the study unveils some valuable lessons. On one hand, it is revealed that recognizing and diagnosing the crisis is critical for subsequent success. An erroneous diagnostic delays the response and, thus,

the probabilities to initiate the turnaround process. On the other hand, the intensity of response has been proved as a relevant variable to be taken into account. Only by taking strategic decisions that consider such factors can the bankrupt firm survive. How can managers gain stakeholders' support to achieve survival and successful turnarounds? Firms' managers should focus on clearly reducing redundant costs in order to generate the necessary cash flows for immediate stabilization and medium-term viability. Also, a change or rationalization of the top management team could be needed. A reduction of such expenses sends a clear signal to stakeholders of the firm's commitment to meet their expectations. At the same time, preserving valuable assets and increasing sales, this is, increasing asset productivity, also contribute to improve the probabilities of success. Only firms operating in stagnating and declining industries should raise cash from asset divestment, while those in growing environments will probably suffer a harm in their resource base that will lead them to failure. Investment during bankruptcy should be a marginal and scrutinized measure, given the resources leverage that it might require.

Finally, another relevant contribution of this research is the retrospective look carried out on turnaround literature, ranging from 1992 to 2017. The most relevant turnaround works found within this period were compared and synthesized, and their main contributions and findings were extracted to better understand the whole BT process, the underlying theoretical grounds and the recent trends in BT research.

Despite its long history and current validity, some BT issues remain relatively unexplored research streams. Most studies lack homogeneous samples in terms of turnaround definition, and even the definition is constantly being changed, depending normally on performance indicators related to industry references. That could be the reason why particularly the study of retrenchment has provided contradictory and equivocal results. Also, understanding the dynamics and agents involved in the process has become increasingly important due to the recent investigation on the path-dependent nature of the turnaround process. All in all, the aim of this research was to contribute BT literature employing a homogeneous sample of firms which attempt turnaround from an

objective position of bankruptcy. Thus, the findings provide further consistency than those that were extracted from heterogeneous samples. Nonetheless, it can be argued that findings from Spanish bankrupt firms will not be easily transferable to other countries with different bankruptcy regimes, an issue that may be tested in future investigations. It is expected, though, that bankruptcy regimes from the EU tend to homogenize in the future, so these contributions might prove useful in such context.

It is relevant also to highlight the use of Spanish bankrupt firms. As far as it is known, no prior turnaround studies have employed Spanish firms, which adds to the contextual and institutional area of BT. Spain has been a neglected context for turnaround scholars despite its notable interest. The low efficiency of the bankruptcy procedure and the relatively young age of this legal regime may have kept turnaround scholars away from it. However, its remarkable specificities, as found by previous academicians, made advisable a deep immersion as the one attempted in this research.

5.3. Limitations and future research streams.

Despite its several contributions, this research is not exempt of limitations. In first place, given the recent reforms of the Spanish bankruptcy law, the regime is relatively young and thus, data available was limited to the period 2012-15. As time passes by, a larger number of bankrupt firms will integrate the Bankruptcy Public Register and could be incorporated to a similar research to observe the validity of the findings. This research thus may constitute the basis for a wider longitudinal study on firm failure and turnaround in Spain. Besides, the sample employed in this research could be observed in the subsequent years to study the evolution of the firms. As a consequence, far more scenarios could be researched, such as surviving firms that do not accomplish the reorganization plan and liquidate, or marginal survivors that improve their performance in subsequent years and achieve sustained survival and pay all debts back to creditors. Also, the preceding situation could be addressed employing this framework. Firms that decline until becoming bankrupt or that cease trading without even attempting a turnaround are of interest and some of the principles found in this research could be applied to them. Therefore, the fields of turnaround and bankruptcy become definitely united thanks to these contributions.

Secondly, another limitation is that only two points in time were taken to evaluate retrenchment and recovery strategies adopted by bankrupt firms. While this is an effective and quick manner to capture the actions of the firms, as done in the majority of turnaround studies, it must be recognized that some nuances can be lost in the process. There could be some firms that, taking the whole bankruptcy procedure, reduce their assets, but perhaps they increased them in the first year of bankruptcy and, after realizing the error or being forced by stakeholders, they overreacted and reduced them in excess. Also, the sequence of actions has not been considered, although it may yield a critical importance for success. For instance, it has the same effectiveness to retrench first in costs and second in assets than vice versa? Cost retrenchment in the first year of bankruptcy has effects on cost retrenchment in the second? Sales-increase can be taken during cost-retrenchment? What bankrupt firms should invest in when

operating un munificent industries? Discussing about these questions may provide a deeper understanding of both the turnaround content and process, for which qualitative research and, specifically, case studies (Eisenhardt, 1989; Yin, 2008) may produce interesting nuances and a more complete understanding of the process.

Thirdly, focusing on bankrupt firms embraces a remarkable limitation, which is that a relevant number of firms cease their operations and are liquidated, and no accounting records are available for academicians. Such limitation will persist in the future when studying Spanish bankrupt firms. To overcome that restriction, investigations of bankruptcy administrators' reports could provide deeper insights to the question of firm failure. Bankruptcy administrators have been informants in prior studies and they constitute a rich source for qualitative investigations that should be attempted in the future to better understand the process.

In fourth place, the research does not capture the explicit causes for which the firms became bankrupt. This is one of the main antecedents of the turnaround process, and acknowledging its neglect is vital to understand this research. Although this limitation has been partially overcome by including the moderating role of the competitive environment and structural factors, such as time, size, slack, prior performance and industry, the actual reason why bankrupt firms took one strategy or other has not been considered in the study. Prior scholars recognized that adequate turnaround actions took into account the causes of decline as a starting point to design the turnaround. In that sense, external causes required the adoption of mainly repositioning strategies and internal causes shall be cured with operational measures. However, catching the causes of the crisis is an overwhelming task, as shown by prior scholars, which would have implied a notable widening of this research. Thus, it far escaped the defined scope of investigation, while it is acknowledged the need to consider it in the future.

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Resumen Ejecutivo

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Estrategias de reflotamiento para crisis severas. Sobrevivir al concurso de acreedores

El reflotamiento empresarial (*business turnaround* – BT) ha sido un tema de interés para los académicos de la estrategia empresarial durante muchas décadas. Como resultado de la Gran Recesión, ha surgido un renovado interés por la materia, dado el elevado número de empresas que han sufrido problemas operativos o financieros en este periodo hasta el punto de abocarlas al concurso de acreedores. Esta investigación se centra en empresas en declive y que sufren la crisis de mayor gravedad, la insolvencia legal – concurso de acreedores –, pero que al mismo tiempo tienen la voluntad de sobrevivir y recuperar sus resultados anteriores. Por ello, las empresas que tienen unas expectativas de vida limitadas, que tomaron la decisión de ser liquidadas o vendidas en conjunto han sido descartadas para el estudio.

La mayoría de las empresas entrará en una situación de declive, esto es, un periodo en el que los resultados negativos amenacen seriamente su viabilidad, a lo largo de su vida. El modo en que las empresas afrontan el declive y posteriormente recuperan sus resultados es el tópico principal del BT (Hofer, 1980), una pregunta que debe ser respondida en el contexto de la estrategia empresarial. De hecho, "la razón por la que las empresas tienen éxito o fracasan es quizás la cuestión central al estudiar estrategia" (Porter, 1991; 95). Sin embargo, tal y como afirman Trahms et al. (2013:1278): "las preocupaciones y desafíos a los que se enfrentan los directivos cuando ejecutan un proceso de reflotamiento empresarial son únicas y distintas de aquellas que se derivan de mejorar los resultados en una situación en la que no hay declive". Por lo tanto,

el BT es sustancialmente distinto de otras áreas de la estrategia, dadas las particularidades de un declive empresarial.

Al enfrentarse a una situación de declive, las empresas deben reaccionar para frenarla (Weitzel y Jonsson, 1989) a través de la implementación de estrategias de reflotamiento. Un proceso de BT completo comprende el diagnóstico de la *situación*, la implementación de las *respuestas* apropiadas, que finalmente arrojan el *resultado* del proceso. No obstante, el BT ha sido confundido a menudo con otras acciones de cambio organizativo, que tienen un alcance mucho más limitado y no tienen la intención de sacar a la empresa de una situación en la que su viabilidad está en juego (Pandit, 2000). Esto habitualmente conlleva importantes dificultades en el estudio del proceso de reflotamiento y su correcta comprensión. Con el fin de establecer una vía clara respecto al marco teórico de la presente investigación, se ha llevado a cabo una revisión de la literatura de BT más relevante. En base a dicha literatura, surgieron varias cuestiones no resueltas: ¿El marco del reflotamiento es útil para las empresas en concurso de acreedores? ¿Las estrategias de reflotamiento son efectivas para que las empresas en concurso puedan sobrevivir y recuperar su rentabilidad? ¿La intensidad de la respuesta al declive tiene impacto en el resultado del proceso? ¿El entorno competitivo modera la adopción de las estrategias de reflotamiento?

La presente investigación tiene una marcada naturaleza proactiva: las empresas deben reaccionar frente al declive si quieren sobrevivir y recuperar sus resultados anteriores. No hacer nada o incluso actuar tarde tiene efectos perniciosos de largo alcance, derivados del dinamismo intrínseco del proceso de declive (Tangpong et al., 2015). Además, las acciones implementadas están condicionadas por diversos factores de contexto y las causas del declive, de modo que es necesario un diseño a medida de las respuestas de reflotamiento para que este tenga éxito. Adicionalmente, las acciones adoptadas tendrán un impacto en la totalidad de la estructura empresarial, por lo que los posteriores cambios organizativos afectarán a las esferas tanto estratégica como operativa de la empresa. El proceso de BT completo, si se implementa correctamente, produce una transformación sustancial en la estructura de la empresa y su

comportamiento y, como consecuencia de ello, en sus resultados (McKiernan, 2003).

Por ello, y a pesar de los esfuerzos desde el poder político de fomentar la creación de empresas y el emprendedurismo, la posición que mantiene esta investigación es que la rotación del número de empresas debe reducirse, preservando las que ya existen. Esto no significa que la supervivencia empresarial se consiga a cualquier coste. Tal y como propone la literatura, las empresas no viables deben cesar su actividad y sus recursos deben ser reinvertidos en proyectos rentables (Altman y Hotchkiss, 2006; Cook et al., 2011). No obstante, y al mismo tiempo, las empresas viables que sufren dificultades financieras deben ser rescatadas y reflotadas, con el fin de conservar el empleo que generan, el valor de sus activos y su *know-how* (Gilson, 2010).

Una motivación adicional para la presente tesis procede de la adquisición de un conocimiento relativamente profundo del sistema concursal español, derivado de la actividad profesional del investigador durante los últimos ocho años. En la totalidad de países desarrollados, los sistemas concursales se ocupan de la insolvencia empresarial, esto es, su incapacidad para pagar las deudas (López-Gutiérrez et al., 2012). Tal y como ha ocurrido en países comparables, un número importante de empresas españolas intentaron reflotarse desde una posición de insolvencia, ya que el procedimiento concursal provee de herramientas y mecanismos interesantes para estabilizar el declive, restructurar las deudas y recuperar la rentabilidad (Fernández, 2004). No obstante, la eficacia del sistema concursal español es extremadamente baja dado que muy pocas empresas sobreviven al mismo, en claro contraste con lo que sucede en entornos comparables (García-Posada y Mora-Sanguinetti, 2012). Por lo tanto, el sistema de insolvencia español merecía una investigación específica dado que la efectividad del reflotamiento en este contexto ha resultado ser muy pobre.

¿Cuál puede ser el origen de la disparidad en la efectividad de las estrategias de reflotamiento? De acuerdo con la literatura de BT, la diferencia entre las empresas exitosas y las que fracasan se explica por las estrategias adoptadas para revertir el declive y recuperar la rentabilidad (Robbins y Pearce,

1992). Estas estrategias han sido clasificadas en dos fases, que también contemplan su contenido estratégico: fase defensiva (*retrenchment*) y fase de recuperación (*recovery*). Las estrategias defensivas se centran en la estabilización del declive y la corrección de las ineficiencias operativas (Bibeault, 1982; Hambrick y Schecter, 1983; Hofer, 1980; Pearce y Robbins, 1993), mientras que las estrategias de recuperación se implementan para reorientar la empresa hacia aquellas áreas en las que puede tener ventajas competitivas sostenibles (Barker y Duhaime, 1997). La efectividad de las estrategias de reflotamiento depende de las causas y gravedad del declive, mientras que existen otros factores que contribuyen a modular el resultado del proceso (recursos disponibles, entorno competitivo, liderazgo, etc). El foco de esta investigación está puesto en la efectividad de las estrategias de reflotamiento en un contexto de crisis de máxima gravedad (insolvencia) las cuales, a la vista del entorno organizativo, se espera que tengan un impacto significativo sobre las probabilidades de supervivencia y posterior recuperación.

Sin embargo, aunque los trabajos previos han validado de forma consistente los resultados relativos a las estrategias de recuperación, la validación empírica de las estrategias defensivas ha sido frágil y ambigua. Mientras que Robbins y Pearce (1992) defienden fervientemente la necesidad de implementar estrategias defensivas sea cual sea la causa del declive, los estudios posteriores han arrojado resultados contradictorios con esta afirmación. Por ejemplo, Lim et al. (2013: 42) afirman: "… las estrategias defensivas son unas de las más empleadas; no obstante, se trata de un asunto poco estudiado e incomprendido … Las investigaciones empíricas que dan soporte a las estrategias defensivas han sido limitadas o ambiguas; y poco se sabe acerca de cuándo, cómo y de qué forma se deben adoptar." De forma similar, Trahms et al. (2013: 1296) afirman: "Principalmente, las últimas dos décadas hemos sido testigos de un aumento del número de investigaciones respecto a las estrategias defensivas y de recuperación en un reflotamiento. Mientras que los resultados son consistentes y muestran resultados positivos de las acciones de recuperación, el efecto de las estrategias defensivas está lejos de estar asentado."

Hay dos razones principales por las que se explican estos resultados contradictorios. En primer lugar, las muestras empleadas han sido excesivamente heterogéneas. En particular, las empresas incluidas en las muestras de estudios de reflotamiento no empiezan todas desde el mismo punto. Empresas solventes e insolventes se han mezclado entre definiciones más o menos precisas de declive, que incluyen también empresas rentables que operan en sectores en declive o empresas con pérdidas bajo amenaza de liquidación (Pandit, 2000; Schweizer y Nienhaus, 2017). De forma similar, las amplias definiciones de lo que se entiende por reflotamiento han incluido a empresas que pretenden únicamente sobrevivir a un entorno complejo con otras cuyo objetivo es conseguir ventajas competitivas sostenibles, y que por lo tanto operaban en mejores condiciones que las primeras. En segundo lugar, algunas variables relevantes tales como la intensidad de la respuesta o el entorno competitivo, fueron conceptualmente consideradas en trabajos precedentes (Lim et al., 2013; Ndofor et al., 2013; Sudarsanam y Lai, 2001), pero sus efectos en situaciones de máxima gravedad de la crisis fueron pasados por alto.

Esta tesis aborda esas debilidades. Por un lado, emplea una muestra de 599 empresas españolas con un punto de comienzo muy similar: todas son insolventes y afrontan su reflotamiento dentro del concurso de acreedores. Los términos "insolvencia" y "concurso de acreedores" han sido diferenciados en esta investigación. "Insolvencia" se refiere a la imposibilidad de pagar las deudas debido a dificultades financieras, mientras que "concurso de acreedores" es un procedimiento judicial formal. Estos términos han sido empleados en ocasiones de forma indistinta (Altman y Hotchkiss, 2006). No obstante, en este trabajo, una empresa *insolvente* (incapaz de pagar sus deudas) debe solicitar el *concurso de acreedores* (un procedimiento formal). Únicamente se ha localizado un estudio que haya examinado la importancia de las estrategias de reflotamiento en empresas insolventes en concurso de acreedores (Collet et al., 2014), pero el mismo no evaluó la efectividad de dichas estrategias. Este olvido puede explicarse por Franks y Sussman (2005), quienes afirman que los procedimientos legales de insolvencia han sido considerados como un medio para la liquidación de las empresas, de modo que carecían de interés para los

académicos del área de BT. Por otro lado, esta investigación tiene en cuenta la efectividad de las estrategias defensivas y de recuperación, así como su intensidad, en una muestra homogénea de empresas que sufren una crisis de extrema gravedad, así como el papel moderador del entorno competitivo en las mismas.

En consecuencia, las hipótesis principales de la tesis son que, en un concurso de acreedores, la adopción de determinadas estrategias defensivas y de recuperación, y su intensidad, tendrán un impacto en la probabilidad de que exista un reflotamiento exitoso. Ello se evalúa por medio del estudio del recorte de costes y activos como estrategias defensivas, y el incremento de ventas y la realización de inversiones como estrategias de recuperación, midiendo igualmente la intensidad de la respuesta. Además, los contextos de concurso de acreedores y reflotamiento se han unido por medio de la creación de tres posibles resultados a partir de la combinación de los resultados del primero (liquidación y supervivencia) con los resultados del segundo (éxito y fracaso). Dicha combinación, que se ha empleado para validar las hipótesis, resultó en tres posibles salidas del proceso de reflotamiento en el concurso de acreedores: liquidación, supervivencia marginal y supervivencia exitosa. Además, se tuvo en consideración el papel moderador del entorno competitivo, de acuerdo a trabajos previos (Morrow et al., 2004; Ndofor et al., 2013).

Atendiendo a los objetivos planteados y los contenidos revisados, la estructura de la tesis se divide en cinco capítulos. En el Capítulo 1 se presenta la revisión del marco teórico, que comprende la literatura de BT, dificultades financieras e insolvencia empresarial. En el Capítulo 2, los resultados de la literatura existente y los huecos de investigación existentes se exponen, y se plantea la construcción de la hipótesis. El Capítulo 3 se ocupa de la metodología de investigación. Teniendo en cuenta la literatura revisada, los modelos propuestos evalúan la capacidad explicativa de las estrategias de reflotamiento para que las empresas en concurso alcancen resultados exitosos. Por ello, se ha diseñado una investigación cuantitativa y se eligió la regresión logística multinomial como el modelo para la validación empírica. En el Capítulo 4 se exponen los resultados empíricos, así como la discusión de los mismos.

Finalmente, en el Capítulo 5 se presentan las principales conclusiones, contribuciones y limitaciones del trabajo junto con las potenciales líneas de investigación futuras.

Conclusiones generales

Los problemas económicos y financieros causados por la Gran Recesión a un gran número de empresas de todo el mundo ha renovado el interés en las estrategias y proceso de BT. A pesar de que la literatura de reflotamiento tiene una historia de 40 años, muy poca atención se ha prestado a cómo las empresas en concurso de acreedores pueden abordar el reflotamiento y conseguir la supervivencia. A la luz de la crisis global de 2008, las profundas modificaciones operadas en los regímenes de insolvencia en todo el mundo siguiendo los principios del *Chapter 11* de Estados Unidos aportaron una serie de herramientas para que las empresas insolventes pudieran sobrevivir. ¿Por qué iba a ser más conveniente salvar una empresa en dificultades que dejar que desaparezca y en su lugar crear una nueva? Las instituciones internacionales y los académicos señalan que las empresas que consiguen superar una crisis son más resilientes, una habilidad que les será de gran utilidad en futuros periodos de recesión. Además, conservar sus activos es más valioso que destruir ese valor y rehacerlo nuevamente, lo cual conllevaría grandes esfuerzos, dinero y tiempo. En dicho propósito, un régimen de insolvencia efectivo debería distinguir entre empresas viables y no viables. El procedimiento debería permitir que las empresas viables sobrevivan y que las no viables sean liquidadas y sus recursos sean invertidos en proyectos rentables. A pesar de los múltiples avances en este sentido, el sistema español de insolvencia todavía tiene un largo trecho por recorrer.

El objetivo de esta investigación era el de arrojar luz sobre las razones que motivan la supervivencia y éxito de las empresas españolas en concurso de acreedores, así como orientar a los legisladores, académicos y directivos para afrontar situaciones de crisis de extrema gravedad en el futuro. En particular, se trató de dar respuesta a las siguientes cuestiones que sirven de guía para la investigación: ¿Las estrategias defensivas sobre costes y activos son efectivas para aumentar las probabilidades de reflotamiento? ¿Las estrategias de

recuperación son adecuadas para empresas en concurso de acreedores? ¿El entorno competitivo influye en la efectividad de las estrategias de reflotamiento durante el concurso de acreedores? Los trabajos previos en la literatura de BT han mostrado que las estrategias defensivas tienen resultados desiguales en función del contenido de las acciones adoptadas. Así mismo, la adopción de estrategias de recuperación no es homogénea entre las empresas en dificultades. Por último, los académicos han señalado que el entorno competitivo es un condicionante crítico en la efectividad de las acciones de reflotamiento. Los marcos conceptuales de la insolvencia y reflotamiento se han ligado combinando los dos principales resultados del concurso de acreedores (liquidación y supervivencia) con los del reflotamiento (éxito o fracaso), a partir de los que se han construido los resultados de la variable dependiente de esta tesis doctoral: liquidación, supervivencia marginal y supervivencia exitosa.

Las características de la muestra, así como el análisis longitudinal llevado a cabo en el contexto teórico adoptado aportan un sólido sustento a diversas lecciones, que pueden ser tenidas en cuenta para afrontar situaciones en las que las empresas vean su viabilidad amenazada en España. Es un principio asentado que el cierre de un negocio implica consecuencias dolorosas (tales como pérdida de puestos de trabajo) e iniciar uno nuevo tiene grandes costes que no pueden ser fácilmente asumidos. Por ese motivo, los legisladores han abogado por leyes de "segunda oportunidad", con el fin de reducir la mortalidad empresarial. Es sobre ese principio sobre el que las proposiciones de esta investigación están construidas. En esa línea, las conclusiones extraídas de los análisis empíricos abogan por la continuidad de los negocios ya existentes. Además, estas conclusiones tienen un valor añadido: proceden de empresas resilientes. Tal y como se expone en los análisis, la resiliencia deriva de afrontar y superar situaciones de extrema crisis en un sistema concursal de muy baja eficiencia como es el español.

En concreto, los resultados obtenidos muestran que las respuestas al declive importan, pero no son igualmente efectivas en función del contenido y las condiciones en las que se adoptan. Las evidencias revelan que es necesario hacer un escrutinio cuidadoso cuando se implementan estrategias defensivas.

Dicho escrutinio se asienta sobre dos pilares: 1) un recorte profundo y efectivo de costes y 2) una reducción moderada (o ninguna) de los activos. Las medidas de reducción de activos son particularmente relevantes en el proceso de reflotamiento, dado que su implementación indiscriminada lleva directamente al fracaso, contrariamente a lo que algunos autores precedentes descubrieron. Adicionalmente, las estrategias de recuperación descansan sobre: 1) estrategias de incremento de ventas después de adoptar estrategias defensivas y 2) llevar a cabo nuevas inversiones en función del entorno competitivo. El tiene influencia tanto las reducciones de activos como las inversiones, en el sentido que se proponen estrategias opuestas en entornos benignos y estancados o en declive. Mientras que los entornos benignos presentan oportunidades de inversión, la reducción de activos en los mismos no es aconsejable. Por el contrario, los sectores estancados o en declive muestran una asociación positiva entre la reducción de activos y el éxito en el proceso, mientras que la realización de inversiones reduce la probabilidad de superar el concurso de acreedores.

De forma resumida, se puede afirmar que los procesos de reflotamiento exitosos durante un concurso de acreedores se consiguieron cuando las empresas implementaron las estrategias defensivas y de recuperación adecuadas, y que fomentaban la conservación de los activos más valiosos y al mismo tiempo se podían aprovechan el entorno competitivo en el que desarrollan su actividad. Esto implica que, independientemente de su tamaño, sector o gravedad de la crisis, un proceso de reflotamiento exitoso se basa en la adecuación de las estrategias adoptadas por la empresa, y no en el efecto de factores coyunturales u otros elementos no controlables por los directivos. Cabe incidir en que la distinción entre las empresas que acabaron siendo liquidadas y las que sobrevivieron marginalmente sí se debía en gran medida a los mencionados factores estructurales, de modo que parece existir un umbral de recursos a partir del cual las empresas pueden sobrevivir al concurso de acreedores, tal y como la literatura propone.

Con todo ello, se aportan contribuciones e implicaciones relevantes para académicos, legisladores y directivos. En primer lugar, el trabajo contribuye a

unir concurso de acreedores y supervivencia empresarial a través de la literatura de BT. El marco teórico prueba ser adecuado y útil para el estudio del problema. De hecho, la respuesta a la pregunta de por qué las tasas de supervivencia en el concurso de acreedores son tan bajas puede ser abordada desde el marco del reflotamiento en términos de contenido, intensidad y adecuación al entorno. En concreto, esta investigación aboga por la implementación las medidas defensivas adecuadas, debiendo centrarse la empresa en reducir sus costes en profundidad con el fin de estabilizar el declive, y al mismo tiempo conservar sus activos más valiosos. Además, incrementar las ventas tras haber adoptado medidas defensivas y aprovechar las oportunidades de inversiones, cuidadosamente evaluadas y únicamente en entornos en crecimiento, también aumentan las posibilidades de éxito. Sin embargo, sin un reconocimiento apropiado de la situación de crisis, voluntad de actuar y una rápida y decidida respuesta resulta imposible superar el concurso de acreedores.

Los resultados del trabajo además aportan a los legisladores nuevas pistas para regular en materia de insolvencia, y ello con el fin de incrementar la eficiencia del sistema concursal a través de la supervivencia de más empresas. Esta investigación traza los perfiles de las empresas que se liquidan, sobreviven de forma marginal o sobreviven de forma exitosa. Las diferencias entre ellas son significativas. Junto con una respuesta rápida y acciones de reducción de costes e incremento de ventas, los legisladores deberían fomentar que las empresas en concurso de acreedores alcanzan el procedimiento con recursos suficientes para afrontarlo, factor clave para la supervivencia, y con sus activos más valiosos todavía bajo su control. A pesar de que el tradicional principio de que las estrategias defensivas deben ser adoptadas en sus formas más variadas y de forma más o menos indiscriminada, se comprueba que reducir intensamente los activos es perjudicial para la supervivencia de las empresas en concurso, dado que los beneficios inmediatos que ello proporciona (liquidez por la venta) no compensan sus costes estratégicos a largo plazo. Así mismo, el papel de los *stakeholders* no debe ser desdeñado, dado que puede cambiar la evolución de la empresa y sus probabilidades de sobrevivir y recuperar su rentabilidad. Los

stakeholders son una parte crítica en particular en las decisiones de inversión, que deben ser medidas de forma prudente durante el concurso.

A nivel directivo, el trabajo revela algunas valiosas lecciones. Por un lado, se reconoce que reconocer, diagnosticar y actuar frente a la crisis es crítico para el éxito posterior. Un diagnóstico erróneo retrasa la respuesta y, por lo tanto, las probabilidades de iniciar el proceso de reflotamiento. Por otro lado, la intensidad de la respuesta es una variable que ha probado ser relevante y debe ser tenida en cuenta en futuros trabajos. Se puede afirmar, a la luz de los resultados obtenidos, que el éxito en un concurso de acreedores descansa también sobre una adecuada intensidad de las medidas adoptadas. Únicamente tomando decisiones estratégicas que la consideren es posible que la empresa en concurso tenga éxito en el proceso concursal. ¿Cómo pueden los directivos recuperar el apoyo de los *stakeholders* para conseguir sobrevivir y recuperar su rentabilidad? Los directivos deben centrarse en reducir aquellos costes redundantes con el fin de generar la suficiente tesorería que permita la estabilización de la empresa y la viabilidad a medio plazo. Además, puede requerirse un cambio o racionalización del equipo directivo. Una reducción de dichos costes envía una señal clara a los *stakeholders* en cuanto a su compromiso con el cumplimiento de las obligaciones derivadas del convenio. Al mismo tiempo, conservar los activos más valiosos y aumentar las ventas, o lo que es lo mismo, incrementar la productividad de los activos, también contribuye a mejorar las probabilidades de éxito. Únicamente aquellas empresas que operen en sectores en declive o estancados deberían obtener liquidez de las desinversiones, mientras que las que operan en sectores en crecimiento deben evitarlo, en tanto que es probable que se dañe de forma irreversible su base de recursos para el futuro y ello las lleve al fracaso. Invertir durante un concurso de acreedores debería ser una medida marginal y muy estudiada, dados los recursos que dicha decisión implica emplear.

Finalmente, otra contribución relevante de la investigación es el análisis retrospectivo llevado a cabo de la literatura de reflotamiento, desde 1992 a 2017. Los trabajos más relevantes del tópico fueron analizados y sintetizados, y se

extrajeron las principales contribuciones y resultados para obtener una mejor comprensión del proceso de BT, los pilares sobre los que se asienta el mismo y las tendencias más recientes en el estudio de la materia.

A pesar de su larga trayectoria y la validez de muchos de sus principios, algunas cuestiones del BT empresarial siguen estando inexploradas. La mayoría de los trabajos carecen de muestras sustancialmente homogéneas en términos de definición de reflotamiento, e incluso la propia definición del término está en constante cambio, que habitualmente depende de indicadores de rentabilidad vinculados con referencias sectoriales. Ese puede ser el motivo por el cual el estudio de las estrategias defensivas en particular ha tenido resultados contradictorios o ambiguos. Adicionalmente, comprender las dinámicas y los agentes implicados en el proceso se ha convertido en una cuestión que genera un creciente interés, debido a las recientes investigaciones en la naturaleza de trayectoria dependiente del reflotamiento. Atendiendo a lo anterior, un objetivo de la tesis era contribuir a la literatura de reflotamiento empleando una muestra homogénea de empresas que afrontar todas ellas el reflotamiento desde una posición objetiva de concurso de acreedores. Por ello, los resultados de la tesis tienen una mayor consistencia que aquellos que fueron extraídos de muestras heterogéneas. No obstante, se podría argumentar que los resultados obtenidos de empresas españolas en concurso de acreedores no pueden ser fácilmente transferidos a empresas de otros países en situaciones similares, un asunto que debería ser evaluado en futuras investigaciones. Se espera, sin embargo, que los regímenes de insolvencia de la UE tiendan a homogeneizarse en el futuro, de modo que las contribuciones del trabajo pueden resultar útiles en dicho contexto.

Conviene destacar igualmente el uso de empresas españolas en concurso de acreedores para la realización del estudio. Hasta donde se sabe, ningún estudio previo del área del reflotamiento empresarial ha empleado empresas españolas, lo cual es una aportación contextual e institucional a la literatura de reflotamiento. España ha sido un contexto ignorado por los investigadores anteriores, a pesar del notable interés que resulta tener, lo cual puede venir derivado de la juventud del procedimiento concursal y la baja eficacia del

mismo. No obstante, sus notables particularidades hacen aconsejables inmersiones en profundidad como la realizada en esta investigación.

Como es lógico, la tesis no está exenta de limitaciones. En primer lugar, dadas las recientes reformas del sistema concursal español, el régimen legal es relativamente joven de modo que los datos disponibles se limitan al periodo 2012-15. A medida que pase el tiempo un número mayor de empresas integrarán el Registro Público Concursal y podrán ser incorporadas a estudios similares con el fin de comprobar la validez de los resultados. Esta investigación además constituye una base para análisis longitudinales más amplios, pues se puede observar la evolución de la muestra en los años posteriores a la superación del concurso de acreedores. Como consecuencia, muchos más escenarios podrían ser tenidos en cuenta, como los casos de empresas que sobreviven, pero no cumplen el convenio y acaban siendo liquidadas, o bien supervivientes marginales que consiguen recuperarse completamente más tarde y pagan la totalidad de sus deudas a los acreedores. También, el estudio de la situación precedente podría ser evaluada empleando este marco. Las empresas que entran en declive hasta que se declaran en concurso, o bien aquellas que cesan sus operaciones sin intentar siquiera su reflotamiento pueden ser de interés y los principios descubiertos en esta investigación pueden serles aplicados. Por ello, las áreas de reflotamiento y concurso de acreedores se interrelacionan definitivamente por estas contribuciones.

En segundo lugar, tomar únicamente dos puntos temporales para evaluar las estrategias defensivas y de recuperación resulta una limitación. A pesar de que es una manera rápida y efectiva de capturar en cierto modo las estrategias adoptadas por las empresas, tal y como se realiza en la gran mayoría de estudios de reflotamiento, hay que reconocer que se pueden perder muchos matices en el proceso. Puede haber empresas que, considerando todo el proceso concursal, reducen sus activos, pero quizás los aumentaron al principio y, tras darse cuenta del error o forzados por sus *stakeholders*, tuvieron una reacción desproporcionada y los redujeron en exceso. Además, la secuencia concreta de las acciones no ha sido considerada, a pesar de su posible importancia para el

proceso. Por ejemplo, ¿es igual de efectivo reducir costes en primer lugar y activos en segundo lugar que viceversa? ¿Reducir costes en el primer año del concurso tiene efectos en la reducción de costes del segundo año? ¿Se pueden aumentar las ventas mientras se reducen costes? ¿En qué deben invertir las empresas en concurso que operan en sectores en crecimiento? El debate sobre estas preguntas puede aportar un conocimiento más profundo del contenido y el proceso de BT, para el cual la investigación cualitativa y, en concreto, los estudios de casos (Eisenhardt, 1989; Yin, 2008) pueden incorporar matices muy interesantes para una completa comprensión del proceso.

En tercer lugar, centrar el estudio en empresas en concurso de acreedores conlleva una limitación destacable, y es que hay muchas empresas que entran al procedimiento que cesan sus operaciones y se liquidan y, por lo tanto, no hay registros contables disponibles para su estudio. Esa limitación seguirá estando presente en trabajos futuros. Con el fin de superarla, investigar el contenido de los informes de los administradores concursales puede aportar visiones adicionales del asunto, y en particular de las empresas liquidadas. Los administradores concursales han sido fuente de información en trabajos precedentes y constituyen una fuente abundante para investigaciones cualitativas que deberían ser abordadas en el futuro.

En cuarto y último lugar, esta tesis no recoge las causas explícitas por las cuales las empresas han sido declaradas en concurso de acreedores. Este es uno de los principales antecedentes del proceso de BT, y reconocer la desatención del mismo es importante para entender los resultados de esta investigación. Aunque esta limitación ha sido parcialmente cubierta incluyendo el papel moderador del entorno competitivo y diversos factores estructurales como el tiempo, el tamaño, excedente de recursos, rentabilidad anterior al concurso y el sector, la razón verdadera por la que las empresas en concurso adoptaron una estrategia u otra no ha sido considerada en el trabajo. Los académicos precedentes reconocieron que las acciones adecuadas tuvieron en cuenta las causas del declive como punto inicial para diseñar el reflotamiento. En ese sentido, las causas externas requieren la adopción de medidas de reposicionamiento o recuperación, mientras que las causas internas deben ser

afrontadas con medidas operativas. Sin embargo, recoger las causas de la crisis es una labor descomunal, tal y como han reconocido los autores anteriores, lo cual habría supuesto una notable ampliación de la investigación. Por ello, su estudio escapa el alcance definido en el trabajo, y al mismo tiempo se reconoce la necesidad de analizarlo en el futuro.